

**TO PROVIDE FOR AN AUDIT OF THE FEDERAL RESERVE
SYSTEM BY THE GENERAL ACCOUNTING OFFICE**

**HEARINGS
BEFORE THE
COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES**

NINETY-THIRD CONGRESS

FIRST SESSION

ON

H.R. 10265

**A BILL TO PROVIDE FOR AN AUDIT BY THE GENERAL
ACCOUNTING OFFICE OF THE FEDERAL RESERVE
BOARD, BANKS, AND BRANCHES, TO EXTEND SECTION
14(B) OF THE FEDERAL RESERVE ACT, AND TO PROVIDE
AN ADDITIONAL \$60,000,000 FOR THE CONSTRUCTION OF
FEDERAL RESERVE BANK BRANCH BUILDINGS**

OCTOBER 2 AND 3, 1973

**Printed for the use of the
Committee on Banking and Currency**



U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 1973

22-355 O

COMMITTEE ON BANKING AND CURRENCY

WRIGHT PATMAN, Texas, *Chairman*

WILLIAM A. BARRETT, Pennsylvania
LEONOR K. (MRS. JOHN B.) SULLIVAN,
Missouri

HENRY S. REUSS, Wisconsin

THOMAS L. ASHLEY, Ohio

WILLIAM S. MOORHEAD, Pennsylvania

ROBERT G. STEPHENS, Jr., Georgia

FERNAND J. ST GERMAIN, Rhode Island

HENRY B. GONZALEZ, Texas

JOSEPH G. MINISH, New Jersey

RICHARD T. HANNA, California

TOM S. GETTYS, South Carolina

FRANK ANNUNZIO, Illinois

THOMAS M. REES, California

JAMES M. HANLEY, New York

FRANK J. BRASCO, New York

EDWARD I. KOCH, New York

WILLIAM R. COTTER, Connecticut

PARREN J. MITCHELL, Maryland

WALTER E. FAUNTROY, District of Columbia

ANDREW YOUNG, Georgia

JOHN JOSEPH MOAKLEY, Massachusetts

FORTNEY H. (PETE) STARK, Jr., California

LINDY (MRS. HALE) BOGGS, Louisiana

WILLIAM B. WIDNALL, New Jersey

ALBERT W. JOHNSON, Pennsylvania

J. WILLIAM STANTON, Ohio

BEN B. BLACKBURN, Georgia

GARRY BROWN, Michigan

LAWRENCE G. WILLIAMS, Pennsylvania

CHALMERS P. WYLLIE, Ohio

MARGARET M. HECKLER, Massachusetts

PHILIP M. CRANE, Illinois

JOHN H. ROUSSELOT, California

STEWART B. MCKINNEY, Connecticut

BILL FRENZEL, Minnesota

ANGELO D. RONCALLO, New York

JOHN B. CONLAN, Arizona

CLAIR W. BURGNER, California

MATTHEW J. RINALDO, New Jersey

PAUL NELSON, *Clerk and Staff Director*

CURTIS A. PRINS, *Chief Investigator*

BENET D. GELLMAN, *Counsel*

JOSEPH C. LEWIS, *Professional Staff Member*

DAVIS COUCH, *Counsel*

ORMAN S. FINK, *Minority Staff Director*

(II)

CONTENTS

	Page
Hearings held on—	
October 2, 1973.....	1
October 3, 1973.....	83
Text of H.R. 10265.....	4

STATEMENTS

Carlock, John K., Fiscal Assistant Secretary, Department of the Treasury.....	7
Mitchell, Governor George W., Vice Chairman, Board of Governors of the Federal Reserve System; accompanied by Frederic Solomon, Director, Division of Supervision and Regulation, Board of Governors, Federal Reserve System.....	101
Staats, Hon. Elmer B., Comptroller General of the United States.....	10

ADDITIONAL INFORMATION SUBMITTED FOR THE RECORD

Brown, Hon. Garry, requested budget information of the Federal Government for the years 1914-73.....	118
Carlock, John K., table entitled, "Direct Borrowing From Federal Reserve Banks, 1942 to Date".....	9
Mitchell, Gov. George W.:	
List of publications of the Federal Reserve Board, dated June 1973..	108
Response to questions of Chairman Patman:	
Amount of convertible foreign currencies as of September 1973..	123
Assets of the Federal Reserve Bank of New York with attached "Statement of Condition of Each Federal Reserve Bank on October 3, 1973".....	119, 120
Patman, Hon. Wright:	
"Federal Reserve Expenditures of Taxpayers' Funds—Only a GAO Audit Will Solve the Problem," submission of report.....	84
"Federal Reserve Portfolio Holdings of U.S. Government Securities, December 31, 1914-July 31, 1973" (table).....	117
Staats, Hon. Elmer B.:	
Accountant's opinion page from the "Annual Report of the Board of Governors of the Federal Reserve System for 1972," by Touche, Ross & Co., Certified Public Accountants, Washington, D.C., dated January 29, 1973.....	22
"Improvements Needed in the Federal Reserve Reporting System for Recognized Dealers in Government Securities," report to the Vice Chairman of the Joint Economic Committee, Congress of the United States, dated October 6, 1971.....	
Response to questions of:	24
Hon. Garry Brown.....	68
Hon. James M. Hanley.....	76
Hon. Lawrence G. Williams.....	72
Suggested alternative language for H.R. 10265.....	14

(III)

TO PROVIDE FOR AN AUDIT OF THE FEDERAL RESERVE SYSTEM BY THE GENERAL ACCOUNTING OFFICE

TUESDAY, OCTOBER 2, 1973

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2128 Rayburn House Office Building, Hon. Wright Patman [chairman] presiding.

Present: Representatives Patman, Barrett, Sullivan, Reuss, Ashley, Moorhead, Stephens, St Germain, Gonzalez, Minish, Gettys, Annunzio, Hanley, Koch, Cotter, Mitchell, Moakley, Boggs, Widnall, Johnson, Stanton, Blackburn, Brown, Williams, Heckler, Crane, Rousselot, McKinney, and Burgener.

The CHAIRMAN. The committee will please come to order.

This morning the committee meets to consider H.R. 10265. The legislation would, first, provide for an audit by the GAO of the Federal Reserve Board, banks and branches; second, extend section 14 (b) of the Federal Reserve Act, that allows the U.S. Treasury to draw funds from the Federal Reserve System; and third, to increase from \$60 million to \$120 million the amount of money that can be spent for the construction of Federal Reserve bank branch buildings.

Perhaps the most important question that must be answered in connection with this legislation is whether or not an agency of the U.S. Government—namely, the Federal Reserve System—can expend taxpayers' funds without accounting to anyone outside of the System for the methods in which the funds were expended.

While it is true that the Federal Reserve System does not operate on appropriated money, at the same time it must be realized that the funds that the System uses to conduct its operation are just as much taxpayers' funds as if they had been appropriated by the Congress. The Federal Reserve System derives its income from interest on Government securities that it holds in its portfolio. Each year interest income which is not used for Federal Reserve expenditures is returned to the Treasury.

Thus, the less money that the Federal Reserve System spends, the greater amount it will return to the Treasury and thus reduce the taxpayers' burden of running our Government.

Since the Federal Reserve Act was signed on December 23, 1913, there has been no audit of the entire Federal Reserve System which was not controlled in some manner by the System itself.

And although the GAO was established in 1921, it has never had the authority to audit the entire Federal Reserve System. Until 1933, the GAO did audit the Board of Governors of the Federal Reserve System, but was not allowed to audit the 12 Federal Reserve banks and their

branches. However, the Banking Act of 1933 removed even the GAO's authority to audit the Board of Governors.

It is my belief that this lack of an outside audit is the main reason why the Federal Reserve System spends money in such a manner that if any other official in any other agency of the Government tried to imitate, that official would wind up in jail.

For example, in 1972, the Federal Reserve System spent \$129,727 in memberships, dues, and contributions to some 260 different organizations such as States and local chambers of commerce, Rotary clubs, bar associations, restaurant associations, public relations groups, press clubs, and even the Ambassador Club of TWA.

Although the Federal Reserve System has discontinued its practice of paying dues to the American Bankers Association, it still spent more than \$80,000 last year for dues in various banking organizations such as the Banking Administration Institute, American Institute of Banking, and the Robert Morris Association.

The various Federal Reserve banks also appear to be indirectly paying dues to some ABA-connected State banking associations. For instance, the New York Federal Reserve Bank spent more than \$8,000 on a luncheon that it hosted during an annual convention of the New York and New Jersey Bankers Associations. The Philadelphia Federal Reserve Bank spent more than \$1,200 for its share of luncheon it cohosed with the New York bank at the New Jersey Bankers Association's annual meeting at Atlantic City.

In addition to the dues and contribution funds the Federal Reserve System also is spending thousands of dollars in travel and moving expenses for employees and potential employees that are not allowed for other Government employees.

As an example, a Mr. M. C. Peterson was transferred from the Seattle branch to the Portland branch of the San Francisco Federal Reserve Bank. The Portland branch paid out \$7,884.90, spread out over 16 occasions, in connection with this transfer. On each occasion the only reason for the payment is a notation, transfer from Seattle branch to Portland branch. It should be noted in connection with this transfer that the Federal Reserve System spent nearly \$8,000 in a transfer of an individual when the distance was only 175 miles.

But perhaps the most extravagant expenditures in this area were made in connection with the hiring of a Mr. Balles as president of the San Francisco Federal Reserve Bank.

Mr. Balles moved from Pittsburgh, Pa., to San Francisco and in connection with this move the Federal Reserve Bank of San Francisco paid \$19,249.18 in four payments over roughly a 3-month period. More than \$14,000 of the \$19,000 total was paid in two payments 5 days apart in December of 1972. The only reason given for any of the payments in connection with the move was Pittsburgh to San Francisco.

Certainly an audit of even the most basic type would have required more of an explanation for an expenditure of more than \$19,000 of the taxpayers' funds than the barebones description provided by the Federal Reserve Service.

The Federal Reserve System also spends the taxpayers' money heavily in the area of athletic, social, and recreational activities. For instance, the Dallas Federal Reserve Bank, during 1972, purchased

1,152 ping pong balls. Since the Dallas Federal Reserve Bank has only 895 employees it means that theoretically there was more than 1 ping pong ball purchased for every employee in the bank.

While Dallas may claim the ping pong expenditure championship, the art award goes to the Federal Reserve Bank of Philadelphia. During 1972, the bank spent \$1,302 for an instructor for the Art Club plus an additional \$529 on art supplies including \$154 for flowers.

If Dallas claims the ping pong championship, and Philadelphia the art award, then the music citation must surely go to the Richmond bank. During 1972 the bank spent a total of \$1,410.63 in connection with the bank's choral group; \$750 was in the form of salary to the choral director, with \$490 going to the choral group's accompanist.

There was also an expenditure of \$170.63 for music for the choral group. A survey of the bank's monthly expenses show that apparently the bank was more vocal in some months than in others. For instance, in June the choral director was paid only \$15, and the accompanist \$10. During May the director was paid \$150 and the accompanist \$100.

These are only a few examples of hundreds of totally unnecessary expenditures made by the Federal Reserve System. During the course of the hearings I will bring out more such expenditures and ask that they be explained by officials of the Federal Reserve System.

Before moving to our first witness, I would like to remind members that these hearings were called pursuant to a vote of the committee in August in which members expressed a desire to learn more about the need for an audit of the Federal Reserve System.

As I recall, the vote to hold these hearings was unanimous, and I am indeed pleased that there is so much interest in this vital subject.

Especially since expenses of the Federal Reserve banks and branches have increased from more than \$197 million in 1964 to nearly \$414 million last year, an increase since 1964 of 210 percent.

Our first witness this morning is John K. Carlock, Fiscal Assistant Secretary, Department of the Treasury, who will discuss the section of the bill dealing with the Treasury Department draw on the Federal Reserve System.

He will be followed this morning by the Honorable Elmer B. Staats, Comptroller General of the United States and tomorrow we will hear from Gov. George W. Mitchell, Vice Chairman of the Federal Reserve System.

[The text of H.R. 10265 follows:]

93^d CONGRESS
1st SESSION

H. R. 10265

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 13, 1973

Mr. PATMAN introduced the following bill; which was referred to the Committee on Banking and Currency

A BILL

To provide for an audit by the General Accounting Office of the Federal Reserve Board, banks, and branches, to extend section 14 (b) of the Federal Reserve Act, and to provide an additional \$60,000,000 for the construction of Federal Reserve Bank branch buildings.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 SECTION 1. (a) The Comptroller General shall make,
4 under such rules and regulations as he shall prescribe, an audit
5 for each fiscal year of the Federal Reserve Board and the
6 Federal Reserve banks and their branches.

7 (b) In making the audit required by subsection (a),
8 representatives of the General Accounting Office shall have

I

1 access to books, accounts, records, reports, files, and all other
2 papers, things, or property belonging to or used by the entities
3 being audited, including reports of examinations of member
4 banks, and they shall be afforded full facilities for verifying
5 transactions with balances or securities held by depositaries,
6 fiscal agents, and custodians of such entities.

7 (c) The Comptroller General shall, at the end of six
8 months after the end of the year, or as soon thereafter as may
9 be practicable, make a report to the Congress on the results
10 of the audit required by subsection (a), and he shall make
11 any special or preliminary reports he deems desirable for
12 the information of the Congress. A copy of each report made
13 under this subsection shall be sent to the President of the
14 United States, the Federal Reserve Board, and the Federal
15 Reserve banks. In addition to other matters, the report shall
16 include such comments and recommendations as the Comp-
17 troller General may deem advisable, including recommenda-
18 tions for attaining a more economical and efficient administra-
19 tion of the entities audited, and the report shall specifically
20 show any program, financial transaction, or undertaking
21 observed in the course of the audit which in the opinion of
22 the Comptroller General has been carried on without author-
23 ity of law.

24 (d) The Comptroller General is authorized to employ
25 such personnel and to obtain such temporary and intermittent

1 services as may be necessary to carry out the audit required
2 by subsection (a), at such rates as he may determine, with-
3 out regard to the civil service and classification laws, and
4 without regard to section 15 of the Act of August 2, 1948,
5 as amended (5 U.S.C. 3109b).

6 SEC. 2. Section 14 (b) of the Federal Reserve Act, as
7 amended (12 U.S.C. 355), is amended by striking out
8 November 1, 1973, and inserting in lieu thereof "July 1,
9 1974" and by striking out "October 31, 1973" and inserting
10 in lieu thereof "June 30, 1974".

11 SEC. 3. The ninth paragraph of section 10 of the Federal
12 Reserve Act, as amended (12 U.S.C. 522), is amended by
13 striking out "\$60,000,000" and inserting "\$120,000,000".

The CHAIRMAN. Mr. Carlock, we are delighted to have you, sir, and I believe that you have a prepared statement. You may present it in your own way. You are recognized.

**STATEMENT OF JOHN K. CARLOCK, FISCAL ASSISTANT SECRETARY,
DEPARTMENT OF THE TREASURY**

Mr. CARLOCK. Thank you, Mr. Chairman, and members of the committee.

I am happy to have the opportunity to appear in support of section 2 of H.R. 10265. That section would extend until June 30, 1974, the existing authority of the Federal Reserve banks to purchase directly from the Treasury public debt obligations up to a limit of \$5 billion outstanding at any one time. In the absence of action, this direct-purchase authority will expire at the end of this month.

The purpose of the direct-purchase authority is to assist in the efficient management of the public finances. On the basis of the record, I do not believe the legislation to extend the authority for a temporary period is controversial. The authority was first granted in its present form in 1942, for a temporary period, and it has been renewed for temporary periods on 17 separate occasions.

Since 1942, the authority has been used prudently, on only a limited number of occasions. Its value does not rest, however, on its frequent or extensive use. It rests, rather, on the fact that, simply by being available, a backstop is provided for all our Treasury cash and debt operations, permitting more economical management of our cash position and assuring our ability to provide needed funds almost instantaneously in the event of any kind of emergency.

Several points may be summarized to indicate why we feel that maintenance of this authority is essential.

First, it provides us with the margin of safety, permitting us to let our cash balance fall to otherwise unacceptably low levels preceding periods of seasonally heavy revenues.

This, in turn, results in balances that are not as high as they otherwise would be during the periods of flush revenues that follow, allowing the public debt to be kept to a minimum and thus saving interest costs to the Government.

Our recent experience illustrates the benefit of being able to operate in this way. In August, you will recall, the money and capital markets were extremely sensitive to demands upon them. It was therefore necessary to keep Treasury borrowing in those markets to a rock-bottom minimum.

We were able to do this because, if cash requirements exceeded our projections, we would have the direct-purchase authority to rely on. As it turned out, our cash requirements did slightly exceed our projections, and we used the direct-purchase authority on one day, August 15, in the amount of \$351 million, and for 9 days between September 7 and September 17 in a maximum amount of \$485 million.

If we had not had the authority, we would have had to borrow considerably more than this amount in the market—probably as much as \$1.5 billion—in order to have a prudent margin, and we would be carrying that amount now in our cash balances which are already seasonally high because of the September cash collections.

In the second place, there is always the possibility that erratic swings in money market conditions or international flow of funds may produce changes of a character that rather suddenly reduce our borrowings from other sources.

While we have never to my knowledge had to use the authority for this reason, the availability of direct access to Federal Reserve credit in such circumstances would permit us the flexibility required to draw on our cash and to arrange alternative financing plans.

Finally, the direct-purchase authority is available to provide an immediate source of funds for temporary financing should this be required by a national emergency on a broader scale. While it has never happened, and we hope it never will, a situation could be possible in which our financial markets would be disrupted at a time when large amounts of cash had to be raised to maintain governmental functions and meet the emergency.

Consequently, the direct-purchase authority has for many years been a key element in all of Treasury's financial planning for a national emergency or a nuclear attack. This is a major reason why the authority should be continued for at least \$5 billion, even though little more than a fifth of that amount has ever actually been used in the past.

I want to emphasize, consistently with these three points, that the direct-purchase authority is viewed by the Treasury as a temporary accommodation to be used only under unusual circumstances.

The Treasury fully agrees with the general principle that its new securities should meet the test of the market. Nor should the direct-purchase authority be considered a means by which the Treasury may independently attempt to influence credit conditions by circumventing the authority of the Federal Reserve to engage in open market operations in Government securities.

In that connection, it is important to emphasize that any direct recourse by the Treasury to Federal Reserve credit under this authority is subject to the discretion and control of the Federal Reserve itself.

This borrowing authority has never been abused. The accompanying table providing details on the instances of actual use, shows that it has been used infrequently and only for limited periods. The borrowings are promptly shown on the daily Treasury statement and the weekly Federal Reserve statement, assuring the widespread publicity that is the best possible deterrent to abuse.

The Federal Reserve also includes the information in its annual report to the Congress. And, of course, this borrowing, like any other Treasury borrowing, is subject to the debt limit.

As an essential backstop to our cash management, and an insurance policy against financial emergency, this authority should be kept available in case of need.

[The table referred to by Mr. Carlock follows:]

DIRECT BORROWING FROM FEDERAL RESERVE BANKS, 1942 TO DATE

Calendar year	Days used	Maximum amount at any time (millions)	Number of separate times used	Maximum number of days used at any 1 time
1942	19	\$422	4	6
1943	48	1,320	4	28
1944	None			
1945	9	484	2	7
1946	None			
1947	None			
1948	None			
1949	2	220	1	2
1950	2	180	2	1
1951	4	320	2	2
1952	30	811	4	9
1953	29	1,172	2	20
1954	15	424	2	13
1955	None			
1956	None			
1957	None			
1958	2	207	1	2
1959	None			
1960	None			
1961	None			
1962	None			
1963	None			
1964	None			
1965	None			
1966	3	169	1	3
1967	7	153	3	3
1968	8	596	3	6
1969	21	1,102	2	12
1970	None			
1971	9	610	1	9
1972	1	38	1	1
1973 ¹	10	485	3	6

¹ Through Sept. 30, 1973.

The CHAIRMAN. Thank you. Mr. Staats, we will ask you to come up to the microphone, and have you as a witness now, and then after you have concluded, members will probably want to ask questions of Mr. Carlock, although his subject has been pretty well covered over previous years, and yours is more new. We are delighted to have you on a subject that there is too little knowledge in the Nation. It is a matter of great importance, and we should have all the information on it that we can.

We will recognize you, Mr. Staats, for presenting your statement, and also, if you do not include your entire statement in the record in your presentation, it may be inserted as it is. Also, each one of you may extend your remarks if you desire to do so, and insert any material that will support your side in any way. That is, either extraneous matter, or basic material of your own, so we are glad to have you, Mr. Staats.

You are Comptroller General of the United States; is that the right title?

Mr. STAATS. That is correct, Mr. Chairman.

The CHAIRMAN. And you are in your job for 15 years. It is the only job that is that way, and you are wholly divorced from the executive branch, and you are only responsible to the legislative branch, is that correct?

Mr. STAATS. That is correct.

The CHAIRMAN. It is an unusual situation, in other words, the law makes it very plain that you are independent. I congratulate you on the fine work that you have done in the past. We are looking forward to hearing your testimony, so you may proceed.

**STATEMENT OF HON. ELMER B. STAATS, COMPTROLLER GENERAL
OF THE UNITED STATES**

Mr. STAATS. Thank you very much, Mr. Chairman. I appreciate your remarks.

We welcome the opportunity to testify before this committee concerning the proposal in H.R. 10265, to require our Office to make annual audits of the Federal Reserve Board, banks, and branches. We have no comments on the other provisions of the bill.

Before I comment on some of the specific points I would like to make concerning the provisions of H.R. 10265, I believe it would be advisable to briefly discuss some of the background on prior proposals to require our Office to audit the Federal Reserve System.

Until 1933 GAO audited the expenditure vouchers of the Federal Reserve Board but not of the banks. The audits were made because of the ruling of the Attorney General in 1914 that the funds obtained by assessment by the Board from the banks to meet the expenses were public moneys.

The Banking Act of 1933, however, superseded this ruling by declaring that these funds were not to be construed as Government funds or appropriated moneys. With this change, the GAO audit of the Board's expenditure vouchers was discontinued.

As you are aware, Mr. Chairman, on occasion our Office has assisted this committee in its work relating to the Federal Reserve System. In 1971, for example, we also completed at your request as chairman of the Joint Economic Committee a study of the reporting system operated by the Federal Reserve Bank of New York for dealers in Government securities.

With one exception, however, we do not have the authority to initiate audits of the several entities of the Federal Reserve System. The exception is the responsibility assigned to us by the act of May 20, 1966, to audit the cancellation and destruction of U.S. currency unfit for circulation.

Specifically, this act provides that:

The Comptroller General of the United States shall audit the cancellation and destruction, and the accounting with respect to such cancellation and destruction, of any currency of the United States unfit for circulation, regardless of who is responsible for, and regardless of who performs, such cancellation, destruction, or accounting. The Comptroller General shall have access to any books, documents, papers, and records which he deems necessary to facilitate an effective audit pursuant to this section.

This audit authority was provided in connection with the change in procedures to transfer authority to destroy unfit Federal Reserve notes, previously vested by law in the Comptroller of the Currency, to the Secretary of the Treasury.

The destruction of most unfit currency is carried out in Federal Reserve banks. We have since reviewed these activities of the Federal Reserve banks on a selected basis each year.

Three reports on this work have been submitted to this committee. In addition, 20 reports have been submitted to the presidents of the specific Reserve banks.

Generally, we have not found significant deficiencies in the administrative procedures and controls over these activities.

The question of whether there should be a GAO audit of the Federal Reserve Board and the Reserve banks was discussed during consideration of the legislation which resulted in the Government Corporation Control Act of 1945. The primary purpose of this act was to provide greater congressional control over wholly owned and partly owned Federal corporations.

It was determined that the Federal Reserve Board and banks should be excluded from the audit provisions of that act. Apparently, the main reasons for this determination was that the Board exercised strong control over the Reserve banks and all of the stock of those banks was owned by member banks rather than by the Government.

A bill introduced on July 20, 1959, in the 86th Congress, H.R. 8302, would have directed the Comptroller General to conduct an audit of the Federal Reserve System for the period commencing with the enactment of the Federal Reserve Act, December 23, 1913, and ending December 31, 1958.

We objected to this measure because it would have required an audit for a 45-year period which, as we then stated, constituted "a tremendous task which would drain our audit manpower assigned to defense and other important Government expenditures."

In subsequent years other bills have been introduced, but not enacted, which would have required GAO to audit the Federal Reserve System. In commenting on such legislation we offered no opinion on whether such an audit by our Office was advisable, but stated that if the Congress wanted such an audit made, we would carry out the congressional intent by making whatever audits the Congress wished.

One of the primary purposes of the Federal Reserve System is the control and regulation of the supply of money and credit. The Federal Reserve System expands and contracts the supply of money and credit primarily by purchasing and selling U.S. Government obligations.

As of June 30, 1973, the Federal Reserve System owned U.S. securities totaling about \$75 billion. The financial statements of the Federal Reserve banks for calendar year 1972 show that total earnings from operations amounted to about \$3.8 billion—

The CHAIRMAN. Would you repeat that please?

Mr. STAATS. Yes; the financial statements of the Federal Reserve banks for calendar year 1972 show that total earnings from operations amounted to about \$3.8 billion of which about 99 percent was derived from interest on U.S. Government securities. Total expenses of the banks in 1972 amounted to about \$442 million including about \$35 million in assessments for the expenses, and other costs of the Board of Governors; nonoperating losses amounted to about \$49 million, member banks were paid dividends of about \$46 million; and about \$51 million was transferred to surplus.

The balance of net earnings, amounting to about \$3.2 billion, was transferred to the U.S. Treasury.

In view of the highly important part the Federal Reserve System plays in the Nation's system of money and credit, we have concluded that there should be a GAO audit of the Federal Reserve Board and the Reserve banks.

However, there are three possible alternatives that may be considered in determining the scope of the audits in the event Congress agrees with our view as to the need for a GAO audit.

One, the first alternative would be an audit of the accounts, financial transactions, and financial reports of the Board, and the Reserve banks. This kind of audit would be for the purpose of arriving at opinions as to whether financial transactions are carried out in accordance with applicable legal requirements and are properly accounted for, and whether the financial reports present fairly the financial position, changes in financial position, and results of operations of the various entities in the System.

As provided in H.R. 10265, our reports on such work would disclose any program, financial transaction, or undertaking which in our opinion was carried out without authority of law. In performing this kind of an audit, we would first make a careful review of the nature and adequacy of all audit work already being performed within the Federal Reserve System under existing arrangements before determining how much additional auditing by us would be needed.

Two, the second alternative would embrace the audit work included in the first alternative but would be extended to include selected examination of the management of resources, such as computers and other equipment, buildings, and personnel, to evaluate the efficiency and economy with which such resources are procured and used. Such audit work would include determining the causes of any inefficient or uneconomical practices found and proposing constructive recommendations for improvement for the consideration of management officials.

H.R. 10265 specifically provides for audit work of this nature since it requires that we include in our reports "recommendations for attaining a more economical and efficient administration of the entities audited."

Three, the third alternative would embrace the kind of audit work described for the first two alternatives but would be further extended to include reviews of the results of the programs and activities of the System, including the extent to which its established objectives are being achieved.

This extension of the scope of our auditing activities was specifically directed in the Legislative Reorganization Act of 1970 with respect to Federal departments and agencies. That act directs us to "review and analyze the results of Government programs and activities carried on under existing law."

As we interpret H.R. 10265, the language is broad enough to embrace this alternative.

The language in section 1(a) of the bill refers to the Federal Reserve Board and the Federal Reserve banks and their branches. The Federal Advisory Council and the Federal Open Market Committee are part of the Federal Reserve System but technically are not a part of the Board of Governors or the Federal Reserve banks, and H.R. 10265 would authorize our office to audit only the Board of Governors

and the Federal Reserve banks and branches. If the Board of Governors and the Federal Reserve banks and branches are to be audited by our office, we believe that the Federal Advisory Council and the Federal Open Market Committee should also be subject to audit by our office.

Section 1(b) of H.R. 10265 states that GAO shall have access to reports of examinations of member banks. We have assumed that this language would give us access to examination reports of member banks in the custody of the Board or the Reserve banks prepared by bank examiners of the Comptroller of the Currency, the FDIC, and the various States, as well as those of the Federal Reserve banks.

We are not, therefore, suggesting any change in the language of H.R. 10265 in this regard. We do suggest, however, that the committee report on the bill make it clear that GAO will be given access to all examination reports, from whatever source, of member banks.

H.R. 10265 calls for an annual audit and also an annual report. We do have reservations about this requirement.

The Federal Reserve System is a large organization and its operations are complex. The additional workload this requirement would thrust on us would be heavy. We would much prefer that the annual audit requirement be removed and that the activities of the Federal Reserve System, if it is to be audited by GAO, be placed on the same basis as those of the Federal departments and agencies so far as frequency of audit is concerned.

Under the Budget and Accounting Act, 1921, and the Budget and Accounting Procedures Act of 1950, the determination as to frequency as well as scope of audit performed is left to our judgment.

These judgments are made in the light of congressional interest in specific programs and problems and, as the 1950 act requires, after giving "due regard to generally accepted principles of auditing, including the effectiveness of accounting organizations and systems, internal audit and control, and related administrative practices."

The audit language in the bill provides that the GAO audit be made under such rules and regulations as we prescribe. In accordance with our regular audit policy, any rules or regulations that we would prescribe would specifically require our auditors to review and evaluate the nature and effectiveness of any auditing already being done in the System in determining the extent of GAO audit work to be performed.

This step is in conformity with generally accepted principles of auditing and is also essential in avoiding unnecessary duplication and expenditure of effort.

The reason for our mentioning this point is that we recognize that a substantial amount of auditing is already being performed in the System.

Under existing arrangements, a firm of independent CPA's makes an annual audit of the accounts of the Board of Governor's, and their opinion on the Board's financial statements is included in the Board's annual report. We understand that copies are furnished to this committee and to the Senate Committee on Banking, Housing, and Urban Affairs.

We also understand that each Federal Reserve bank and branch is examined at least once each year by the Board's staff of field examiners, who are directed by the Board to determine the financial condition of

the bank and compliance by its management with applicable provisions of law and regulation.

The examination includes a comprehensive review of each bank's expenditures to determine if they are properly controlled and of a nature appropriate for a Reserve bank. A public accounting firm is engaged to accompany the Board's examiners on their examination of one Reserve bank each year, to provide an outside evaluation of the adequacy and effectiveness of the examination procedures.

The operations of each bank are also audited by an internal auditing staff on a year-round basis. This work is done under the direction of a resident general auditor who is responsible to the bank's board of directors through its chairman and its audit committee.

The board's examiners review the internal audit programs of each bank each year to see whether the coverage is adequate and the procedures effective.

In view of the substantial amount of auditing already being performed in the System, we believe that a requirement for an annual audit by our Office could result in an uneconomical use of our staff.

If the audit language could be written to give us more flexibility as to the frequency of audit, I am sure that we could provide the Congress with relatively frequent GAO reports on the financial operations of the System and on any problems of specific interest or concern to the Congress made known to us.

The audit language in H.R. 10265 is broad in that it would direct us to make an audit of the board and the Reserve banks and their branches for each fiscal year and no restriction of any kind is stated. Coupled with the provision that the Comptroller General shall prescribe rules and regulations for the audits, the language of the bill as drafted would give us the option of determining the nature and extent of audit work to be done.

If it is intended that the GAO audit embrace all of the alternatives I described earlier and that such audit include the Federal Advisory Council and the Federal Open Market Committee, there is attached draft language, as a substitute for H.R. 10265 which we believe more specifically sets out the type of authority we need.

I do not need to read the suggested alternative language, Mr. Chairman.

The CHAIRMAN. Without objection it will be inserted at the end of your remarks.

[The suggested alternative language for H.R. 10265 referred to by Mr. Staats follows:]

SUGGESTED ALTERNATIVE LANGUAGE

SEC. 1. (a) The Comptroller General is authorized and directed to audit the programs, activities, and financial operations of the Federal Reserve System (including the Board of Governors of the Federal Reserve System, the Federal Reserve banks, branch banks, the Federal Advisory Council, and the Federal Open Market Committee) and to make recommendations for achieving greater efficiency, economy, and effectiveness in the conduct of such programs, activities, and financial operations. The audits shall be made under such rules and regulations as may be prescribed by the Comptroller General. A report of any such audit shall be made by the Comptroller General to the Congress when he deems it necessary to keep the Congress informed of the programs, activities, and financial operations of the System, together with such recommendations with respect thereto as the Comptroller General may deem advisable.

(b) In making the audit required by subsection (a), representatives of the General Accounting Office shall have access to books, accounts, records, reports, files, and all other papers, thing, or property belonging to or used by the entities being audited, including reports of examinations of member banks, and they shall be afforded full facilities for verifying transactions with balances or securities held by depositaries, fiscal agents, and custodians of such entities.

(c) The Comptroller General is authorized to employ such personnel and to obtain such temporary and intermittent services as may be necessary to carry out the audit required by subsection (a), at such rates as he may determine, without regard to the civil service and classification laws, and without regard to section 15 of the Act of August 2, 1948, as amended (5 U.S.C. 3109b).

The CHAIRMAN. I would like to ask you something about the amount of business done by this Federal Reserve. Do you examine the 20 agents of the Federal Reserve Open Market Committee and the Federal Reserve System? The 20 agents all in New York or based in New York are selected by the Federal Reserve System, and they are the only ones that can buy or sell Government bonds for anyone who desires to buy or sell direct from the System's Open Market Committee.

Is that a correct statement, Mr. Staats?

Mr. STAATS. That is my understanding, sir.

The CHAIRMAN. In other words, if anyone, a person or an entity like a corporation or a bank, wants to buy bonds, they would have to buy them through one of the 20 agents; and if they want to sell bonds, they would have to sell them through one of these 20 agents.

Now, about how much business a year is done through those 20 agents, Mr. Staats?

Mr. STAATS. I do not have any figures on that, Mr. Chairman.

The CHAIRMAN. Let us have order, please.

Mr. STAATS. I am afraid I do not have figures on that, other than those which I have included in my statement.

The CHAIRMAN. The amount of business that is done through the open market operations and through other market operations in the New York Federal Reserve Bank would you say aggregated billions of dollars a month?

Mr. STAATS. That would be in rough terms my understanding; but again, I do not have the specific figures.

The CHAIRMAN. Well, of course it is enormous.

Mr. STAATS. Are you talking, Mr. Chairman, about the purchase of Government securities?

The CHAIRMAN. Yes, sir.

Mr. STAATS. I misunderstood you. We do have figures on that. In 1970 the total transactions reported by the dealers in Government securities recognized by the Federal Reserve System was \$738 billion.

The CHAIRMAN. \$738 billion, or \$2 billion a day.

Mr. STAATS. That represents about three times the value of the transactions on the New York Stock Exchange.

The CHAIRMAN. Three times the value of the transactions on the New York Stock Exchange?

Mr. STAATS. Yes.

The CHAIRMAN. That indicates the size of the business that we are engaging in here, and about the tremendous importance to make sure it is done properly. Although we are not charging anybody in the Federal Reserve System of maladministration or wrongdoing, we are not charging any persons, as a Member of Congress, House or Senate, or anybody in the executive branch, or any other branches of Govern-

ment of any wrongdoing; but we want to bring out the size of this operation and show the need for some surveillance, more than we have now, over its operations.

I will forgo asking any other questions at this time, and will yield to Mr. Widnall.

Mr. WIDNALL. Thank you, Mr. Chairman.

Mr. Staats and Mr. Carlock, we certainly welcome you here before the committee and appreciate very much the testimony that you have given. I have a couple of questions for you, Mr. Staats.

You mentioned three degrees of audit which would be possible. The first would seem to involve the so-called fiscal audit of the books and accounts.

The CHAIRMAN. Let us have order, please. We must have attention because this is a matter of great importance, and we hope that we can have good order and attention in order to get all of these facts from Mr. Staats. It is unusual for him to devote so much time to an operation of this kind, but it is so necessary and in the public interest. So let us have attention, please.

Go ahead, Mr. Widnall.

Mr. WIDNALL. I would certainly agree that your agency has the expertise to do audits. However, the more extensive audits suggested in alternatives 2 and 3, you would have to assess judgments of the Board and its related bodies.

We just completed 2 weeks of hearings on such matters, during which time we heard some very knowledgeable witnesses, many of whom disagree. Even after years of dealing with these matters and listening to all of these varying viewpoints, I would be hard pressed to say, for example, whether I think the Board's recent actions on setting interest rate ceilings under regulation were right or not.

How do you expect to approach this kind of examination?

Mr. STAATS. Mr. Widnall, let me say this generally. We felt it would be helpful to this committee if we could suggest three alternative approaches that might be taken to an audit of the Board. We conduct all three types of audits and sometimes in combination. Sometimes we approach it only on one basis.

With respect to the first type of audit, the more traditional type of audit, we believe that it would be of value to the Congress to have the judgment of an independent agency as to the procedures which are applied in selecting the external auditor, how thorough a job he does, what happens to the results of that audit, whether or not there is, for example, good specifications given to the external auditor as to areas that the Board would like for him to cover—this type of thing we have done many times and are, I think, pretty readily understood.

The second type of audit that is referred to here, where we go into the economy and efficiency of the way the agency manages its resources, how it buys its property, and how it handles its inventories, and how it handles its computer operations—these kinds of things are more difficult, but we do this in almost every agency of the Government with the result that we are able to report very substantial savings each year to the Congress as a result of the type of work we do.

I should think that both this first and second type of audit would be relatively noncontroversial from the standpoint of its implications for policy.

Now, when you get to the third type, we would readily agree that this is a much more difficult kind of an audit for us to perform. We do this with a great many Government programs—military weapons systems; we do it with respect to social security programs, agriculture programs, and so on. But I would be the first to agree that this third type is much more difficult and much more sensitive from the point of view of its policy implications for the Board.

Mr. WIDNALL. Mr. Staats, how long do you think it would take and what value would it have to us by the time that you delivered anything to us?

Mr. STAATS. With respect to the first and second type, these can be done fairly speedily. The first type is a matter of weeks or at the most, months. The second type would depend really upon what areas we got into. For example, one of the more complicated areas would be the Board's interest in the use of computers.

Now, we have a sizable staff. We have experts in the utilization and procurement of computers. This type of thing would take longer, but it would all depend as to what type of review we decided to make.

But normally, a more complicated review of this type that we would undertake with respect to other Government agencies might run from a few months up to a year and a half.

Mr. WIDNALL. I am curious to know, have you given any thought to what kind of people you will need to make this examination, and whether or not they would be available to you, and how much expense you are talking about?

Mr. STAATS. With respect to the first two types of audits, we believe that we have adequate staff already in the GAO to undertake these types of reviews. As I have emphasized, they are not really different from those which we conduct all the time.

The third type I would think we would need some additional expertise, additional backgrounds, which we would propose that could be obtained either on a full-time basis or as consultants. We would assume that we would need some experts from the financial field, the banking field.

I might say that we are using consultants very extensively in GAO in other areas where we find the people with backgrounds in particular fields very helpful to us in reviewing our plans and reviewing our draft reports. We have, I believe, something like more than 100 individuals now who serve in a consultant's role to the GAO in different fields ranging all the way from weapons systems across the board to all the other Government operations.

Mr. WIDNALL. Well, I hope you will put into the record what your reaction is to the amount of expense to be involved. And I would also ask whether you charge the agency being audited for these expenses?

Mr. STAATS. No, we do not, except for the Postal Service, for example, we do charge for any audit work we do there because under the law, any services of this type they are required to pay for. But other than that these costs are generally paid for out of our regular budget.

Mr. WIDNALL. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Barrett.

Mr. BARRETT. I would just like to ask Mr. Staats a short question. On page 4 of your statement in the next to the last paragraph, you are

commenting on this legislation. You offer no opinion as to whether such an audit by your office was advisable, but stated that "If the Congress wanted such an audit made, we would carry out the congressional intent by making whatever audits the Congress wished."

And on page 5 in the middle of your statement:

In view of the highly important part the Federal Reserve plays in the Nation's system of money and credit, we have concluded that there should be a GAO audit of the Federal Reserve Board and the Reserve banks. However, there are three possible alternatives that may be considered in determining the scope of the audits in the event Congress agrees with our view as to the need for a GAO audit.

Mr. Staats, we are informed of the extensive audits that are now made by the Board of Governors of the Federal Reserve System by outside CPA firms; and on each Federal Reserve bank and branch.

Are you familiar with these audits and the procedures for them? And if so, what is your opinion of the audit thus made?

And let me conclude—and you can give me your answer—what has occurred to cause the GAO to change its position regarding an audit of the Federal Reserve System and banks?

Mr. STAATS. We have reached this conclusion for the reason that we believe the Federal Reserve Board increasingly plays an important role in our fiscal policy, and operations that relate to the stability of our economy.

We believe that it is not healthy for an organization which is a governmental entity, any organization, to be excluded from some degree of external review so that that advice can be given to the Congress of the United States. That is point 1.

Point 2 is that these are basically Federal moneys that we are talking about here—interest which is earned on securities, which is paid for out of the interest on public debt. It is just as much Federal money as if it were appropriated directly.

I fail to see the distinction of any great degree in moneys earned of that type. From my own background, having served in the Budget Bureau in the executive branch for many years, we considered these earnings on the part of the Federal Reserve as a receipt to the Government, just as any other receipt that was earned from any other source of the Government; and we always included that in the calculations that we made for the President as to whether the budget was going to be balanced or in surplus.

It can be argued that the assessments on the member banks, which are relatively small, are not Federal money. That is not really too serious a point. But the main operations which are involved here involve Federal money.

Now, the reason that the GAO has not been auditing the Board is that the Congress by legislative determination many years ago said that these are not Federal moneys. Congress, by the same kind of legislative action, could say that they are Federal moneys as they have before. This is a matter the Congress really has to make a judgment on.

So for both of these reasons we have come to the conclusion that we ought not to simply take a neutral position on this issue.

Now, I do not know what the Congress is going to do about this matter, and I think obviously it is a matter for their determination; but I would be doing less than my duty to the Congress if I did not tell you personally and frankly how I felt about it.

Mr. BARRETT. Thank you.

The CHAIRMAN. Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman.

I want to welcome both of you gentlemen here this morning. I realize we are embarking on a new role here, which I personally at this point do not approve. I am a strong believer in the independence of the Federal Reserve System. I think our System established in 1913 has given us the strongest, the greatest banking system in the world. There have been relatively few bank failures. And I think one of the things about our success is the independence of the Federal Reserve System.

What this bill wants to do is to turn the GAO into a gigantic fishing expedition into examining this great, great banking system and I think maybe for practical purposes might destroy the confidence that it enjoys, not only in this country but throughout the world.

Now, Mr. Staats, even your substitute bill would, of course, give you broad and vast powers. I suppose if you are going to audit the Federal Reserve System, the first thing you would do is, let's say, seize their minute books, would you not, and read the minutes of all the corporate meetings in all their branches during the year, from the Board, and just go right down through?

Or would you have an accountant sitting in every Board meeting? Just what would you do with the minute books, let's say?

Mr. STAATS. Well, let me make several comments if I may, Congressman Johnson. One is, the language which we have suggested here in our opinion is no broader than the language in the present bill. We think it is an improvement in drafting, but as far as the substance is concerned, we consider it to be the same.

With respect to the independence of the Federal Reserve System, the Federal Reserve Board, I honestly do not believe that an audit as such bears directly on the question of independence at all. The Congress at any time could alter the independence of the Board by legislative action, as you well know.

I am quite willing to agree that the type of audit that would be provided for in these three different alternatives, the third is by far the more sensitive from the standpoint of the concern which you have expressed. But I cannot see how either of the first two types of audits, which are concerned purely with the question of whether or not the financial statements are adequate and whether the auditing system of the Board itself is adequate, and second, whether or not management improvements can be made, which all of us would like to see made in any organization, including yours or mine or any others, by the review of an outside group of experts.

With respect to the first two types of audit, I really have a great deal of difficulty seeing any problems with respect to independence. The third I would be willing to agree is more sensitive; but I did feel that we ought to lay out all three approaches, because we do conduct in our normal operations all three types of audits under present law.

Congress obviously has the option of selecting either one of these three or none of them.

Mr. JOHNSON. Even if we take any one of these and you perform this audit, actually will you not be just trodding the ground that a public accounting firm has already traveled and the same ground that

the internal audits have traveled; if you are really going to do what you call an audit, it would probably be one of the most gigantic audits of all time, or just to audit the \$738 billion on open market transactions would be a prodigious job. And would you feel that in auditing that you should report to the Congress as to the propriety of the \$738 billion worth of operations, or would you just add them up and say they totaled \$738 billion?

Mr. STAATS. No. Let me, if I may, see if I can sort this out a little bit. We would obviously utilize the work of the auditor that they already have and their auditing system. We do this with all agencies. Every agency of the Government has an internal auditing system. A great many agencies hire external auditing agencies as well. Some Federal corporations do that. So we start with their work. And one of the things we are always interested in is whether or not the external auditor has good guidelines from the agency as to what kind of audit it wants to make; and we look at that.

We will look at their reports. If these reports seem to be adequate, then that may be all there is to it. We will check their system, in other words.

One of the questions we would be interested in is whether the Board itself has an auditing committee. Most boards dealing with large operations have an auditing committee. Most corporations have an auditing committee. It is my understanding that the Federal Reserve Board does not.

We do not have to duplicate all of the work of the external audits. If we were to take the position that agency auditing is adequate, we would not be doing any auditing anywhere in the Government, you see, because the same argument could be made about the Defense Department or Agriculture or any other agency of the Government.

But we obviously would want to utilize their work.

Now, with respect to the cost of this, I would not want to be committed to a specific figure, but we have done some work on this; because one of the members of this committee asked us this question, what it would cost us to do this kind of work.

The first category of audit which we are talking about, this first type we estimate would cost us not in excess of \$125,000; and we think we could do it without any addition to our staff.

The second type of audit would be selective. We would be interested in taking a look at some of their administrative operations to see whether we could identify things that might stand some improvement. But that would all depend on how much effort we were to put into it, or indeed, if the Congress wanted us to look at some particular administrative operation.

Now, so far as the third type of audit is concerned, it is more extensive, and I would not want to give you a particular figure.

But the first two types of audits would be relatively inexpensive and could be done with our own staff.

Mr. JOHNSON. Thank you. My time is up.

The CHAIRMAN. Mrs. Sullivan.

Mrs. SULLIVAN. Thank you, Mr. Chairman.

I welcome your testimony, Mr. Staats; and I want to say that I am glad you support the idea of an audit of the Federal Reserve, and I certainly agree any agency handling such funds as Federal funds to

the extent that the Federal Reserve bank does should definitely be the subject of an independent audit by the U.S. General Accounting Office.

I also support your recommendation that it not be done yearly, but I wouldn't want to see it done too infrequently, at least a complete audit such as you have proposed need not be done every year or every other year, but as you say, you would like to have the judgment of your Department or your Agency to make the audits when you think they are necessary.

Now, I would like to ask you—you did answer part of it when Mr. Johnson opposed such a proposal—but what damage could be done to the Federal Reserve if Congress authorizes such an audit?

Mr. STAATS. Well, I have read Chairman Burns' testimony on this point—and I have a high regard by the way for the Chairman; I have known him many, many years and consider him a very good friend. And I am aware of the sensitivities that he has with respect to certain types of transactions, and it could well be that the Congress would want to write in some safeguards on that point.

For example, the GAO about 2 years ago was given the responsibility for the first time of auditing the administrative expenses of the exchange stabilization fund.

Now, the Treasury had always felt that there were sensitive operations involved here, and indeed there are, just as there are in the case of the Federal Reserve Board; but adequate language can be written to preserve to the Board, as it was in the case of the Treasury, to prevent that kind of sensitive information from being made available. Indeed, I would not think it would be necessary to have that kind of information to make an effective review of the System.

But I am quite familiar with the sensitivities, and I have some sympathy with them.

Mrs. SULLIVAN. The Chairman brought out in his statement some of what I would call the little piddling things that go on in the expenditures by the Board. And I do not think that that is all he means. I believe you understand, because many a time in these past years our chairman has discussed certain information that we should really have as to how these funds are obtained, various activities of the open market or how actions by the open market committee affect our entire economy.

And I think that we need some more—just how do you say it—a look-see into what is being accomplished, what is being done, and perhaps some outside judgment of experts to look over all of the operations of this tremendously powerful agency of our Government.

I think this has been needed for a long time. I hope it is done. I think we can act with better judgment if we know that there is a Government agency such as the General Accounting Office looking into the details of an audit such as you mentioned.

And I think the amendments that you have offered could be considered very seriously when we take up this bill; and I appreciate your testimony.

Mr. STAATS. Could I say this with respect to the audits made by the CPA firms; and this is not intended to be critical at all of CPA firms in general, because there are very fine firms involved. But I frankly find some difficulty with the philosophy that the Congress

ought to be willing to accept without question the kind of review that is made by a public accounting firm on an operation as important as this one is, or any other Government operation for that matter.

All you have is a half a page here from—in this case, dated January 29, 1973, Touche Ross & Co., certified public accountants. They say they have reviewed it, and that it is satisfactory; but that does not really communicate very much.

The CHAIRMAN. Would it be all right to put that in the record at this point?

Mr. STAATS. Yes.

The CHAIRMAN. Without objection, so ordered.

[The information referred to by Mr. Staats follows:]

The Annual Report of the Board of Governors of the Federal Reserve System for 1972 included the following opinion of the certified public accountants on the financial statements of the Board.

ACCOUNTANTS' OPINION

Board of Governors of the Federal Reserve System

We have examined the balance sheet of the Board of Governors of the Federal Reserve System as of December 31, 1972, and the related statements of assessments and expenses, and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements for the preceding year were examined by other independent public accountants.

In our opinion, the aforementioned financial statements present fairly the financial position of the Board of Governors of the Federal Reserve System at December 31, 1972, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

TOUCHE ROSS & Co.,
Certified Public Accountants.

We were advised by an official of the Board that it also submitted to the Committee, in addition to the above opinion and the accompanying financial statements, information describing the scope of the CPA's audit.

Mrs. SULLIVAN. Thank you. My time is up.

The CHAIRMAN. Mr. Stanton.

Mr. STANTON. Thank you very much, Mr. Chairman.

Mr. Carlock, we do not mean to ignore you. I am sure you understand.

Mr. Staats, I am delighted to have you come to the hearing this morning. When I first read your statement last night, on the one hand you make it clear that you present three alternatives, but you have expounded a great deal more this morning than what I read into your statement last night.

You are recommending all three steps. You point out the three alternatives, but you did refer to Mrs. Sullivan about the Exchange Stabilization Act. There were safeguards written into the legislation which would protect secret and certain sensitive areas.

Would you agree with me that you could see the possibilities that if we go ahead with parts of this, or some of your alternatives, you would not object to this being done?

Mr. STAATS. I think to be very clear again about it, we believe that any one of these three approaches would be a useful type of audit for the Congress.

The kind of information that we are trying to shape up here is that Congress has three options, three broad options, as we see it, with respect to the type of audit which they would like the GAO to make, if indeed any audit.

Mr. STANTON. One thing I read last night was that, for example, alternative one, performing this kind of audit, you would first make a careful review of the nature and adequacy of all audit work already being performed within the Federal Reserve System under existing arrangements.

Before determining how much additional auditing by us would be needed, would it not be fair for this committee to ask you just to do that; to take on the study of existing audits, and to see where there were weaknesses?

Mr. STAATS. We would be very happy to respond to such a request. I am not sure that we would get much information unless the Board were agreeable to our doing so.

Now, the chairman referred to a study we made with respect to the Federal Reserve reporting system for dealers in Government securities. We had the cooperation of the Board in that study. And in all modesty, I think we did a good job with it, and we were able to point up a very large number of improvements, some of which I believe the Board has accepted.

The CHAIRMAN. May I ask you, could you furnish us a copy of that report that was made available 2 or 3 years ago, and if each member had one, I think it would be well worthwhile.

Mr. STAATS. It is dated October 6, 1971. We would be happy to, Mr. Chairman.

The CHAIRMAN. Without objection, so ordered.

[The report referred to by Mr. Staats follows:]



*REPORT TO THE VICE CHAIRMAN
OF THE JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES*

Improvements Needed In The
Federal Reserve Reporting System
For Recognized Dealers In
Government Securities B-169905

*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-169905

Dear Mr. Vice Chairman:

This is our report on the improvements needed in the Federal Reserve reporting system for recognized dealers in Government securities. Our review was made pursuant to your request of May 1970.

As agreed, we discussed our report with officials of the Federal Reserve Bank of New York. Although they agreed with our findings, they felt that formal comments should come from the Informal Treasury-Federal Reserve Steering Committee which has overall responsibility for the reporting system.

We plan to make no further distribution of this report unless copies are specifically requested, and then we shall make distribution only after your agreement has been obtained or public announcement has been made by you concerning the contents of the report.

Sincerely yours,

A handwritten signature in cursive script that reads "James B. Stewart".

Comptroller General
of the United States

The Honorable Wright Patman
Vice Chairman, Joint Economic
Committee
Congress of the United States

C o n t e n t s

	<u>Page</u>
DIGEST	1
GLOSSARY	
CHAPTER	
1 INTRODUCTION	3
Background	3
Nature of GAO review	7
2 FINANCIAL REPORTS	9
Income	10
All gains and losses not reported in the right reporting period	10
Different methods used to calculate unrealized gains and losses	11
Expenses	12
Questionable allocations	12
Different methods of accounting used in reporting	13
Other	13
Net worth allocation	15
Review of financial statements	16
3 DAILY STATISTICAL REPORTS	18
4 OTHER OBSERVATIONS	20
Problems in analyzing net income	20
Need for refining financial reports	24
Use made of reports	24
Financial reports	24
Daily reports	25
5 SUGGESTED CORRECTIVE MEASURES	26
Strengthening controls over preparation of reports	26
Improving review function	27
Refine financial reports	28
Distribution of aggregate report data	28
Agency comments	28

	<u>Page</u>
I Letter dated May 1970 from the Honorable Wright Patman, the then Chairman, Joint Economic Committee, Congress of the United States	31
II List of financial report deficiencies by type and primary cause	32

GLOSSARY

Accrual accounting	recording of financial transactions in the accounts as they actually take place (that is, as goods and services are purchased or used and as revenues are earned) even though the cash involved in such transactions is paid or received at other dates
Borrowings	funds borrowed to maintain positions
Cash accounting	recording of financial transactions only at the time that cash is received or paid for goods and services
Commitment basis	recording of securities transactions in the accounts on the date agreement to purchase or sell is made
Delivered basis	recording of securities transactions in the accounts on the actual date the securities are delivered
Margin requirements	difference between market value and the maximum loan value of securities
Market value	estimated selling or purchase price of security based on bid and ask quote of dealer
Position	the total value of the securities that a dealer holds for resale
Recognized dealers	Government security dealers who--the Federal Reserve Bank of New York considers--have established a satisfactory financial credit standing and can handle a large volume of trading and accordingly are permitted to deal directly with the trading desk

Repurchase agreement	arrangement for borrowing money whereby securities are "sold" by the dealer with a commitment to buy identical securities back at a specific price
Settlement basis	recording securities transactions on the date agreed upon for delivery of the securities
System open market account	the Government securities held by the Federal Reserve System
Trading desk	the personnel who buy and sell securities for the Federal Reserve Bank of New York
Transactions	purchase or sale of securities

D I G E S T

WHY THE REVIEW WAS MADE

The Federal Reserve Bank of New York operates a voluntary reporting system to accumulate statistical and financial data on the activities of private dealers in Government securities.

Participating dealers report statistical data daily and financial data annually. In 1970 the total transactions reported were \$738 billion, or more than three times the value of transactions on the New York Stock Exchange.

At the request of the then Chairman of the Joint Economic Committee, the General Accounting Office (GAO) reviewed the reporting system to determine whether

--good accounting practices were being followed in preparing the reports and

--the reporting system afforded the Committee and the public with an accurate picture of the operations and profits of the dealers as a group.

GAO examined into the procedures and methods of report preparation employed by six of the 20 dealers in Government securities recognized by the Federal Reserve System.

FINDINGS AND CONCLUSIONS

The daily statistical information furnished by the dealers was reasonably reliable. This information is published regularly for the use of Government officials, financial analysts, and the public. (See p. 18.) GAO does not believe, however, that financial data which is reported annually can be relied upon because

--sound accounting methods were not followed consistently,

--numerous errors were made, and

--different accounting bases were used by the dealers in preparing the reports.

The Federal Reserve Bank of New York made reviews of the reported data; however, these reviews were not effective in ensuring that the information was reliable. (See pp. 9 to 17.)

As a result of errors and inconsistencies, the annual financial data is not published and little use is made of it. (See p. 24.)

RECOMMENDATIONS OR SUGGESTIONS

The reporting system functioning as it does on a voluntary basis is a commendatory achievement. Substantial improvement in the accuracy of the annual financial reports, however, could be made by correcting some of the problems which GAO found. (See pp. 26 to 28.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

Officials of the Federal Reserve Bank of New York told GAO that, although they agreed with GAO's findings and conclusions, the Informal Treasury-Federal Reserve Steering Committee which has overall responsibility for the reporting system would have to decide what corrective action would be taken. (See p. 28.)

MATTERS FOR CONSIDERATION BY THE
VICE CHAIRMAN, JOINT ECONOMIC COMMITTEE

This report outlines some measures that the Federal Reserve System could take to correct the inadequacies in the reporting systems. GAO is including these measures for such action as the Vice Chairman may deem appropriate.

CHAPTER 1INTRODUCTION

In May 1970 the Chairman of the Joint Economic Committee requested that the Comptroller General look into the reporting system established by the Federal Reserve System for dealers in Government securities and advise him as to whether the reporting system was likely to afford the public and the Joint Economic Committee an accurate picture of the operations and profits of these dealers as a group and whether the accounting practices used in reporting were in accord with good accounting standards. A copy of the Chairman's request is included as appendix I.

BACKGROUND

The Federal Reserve System, among its other functions, is responsible under the Federal Reserve Act for maintaining a flow of credit and money that will foster orderly economic growth and a stable dollar. This function is, in part, accomplished through the public sale and purchase of Government securities (U.S. Government and Federal agency securities).

To carry out this function, the Federal Open Market Committee of the Federal Reserve System has the responsibility of determining the policy to be followed in the purchase and sale of Government securities. The objective of the Federal Open Market Committee is to protect the monetary machinery from undue stress and to influence the economy by affecting the cost and availability of credit.

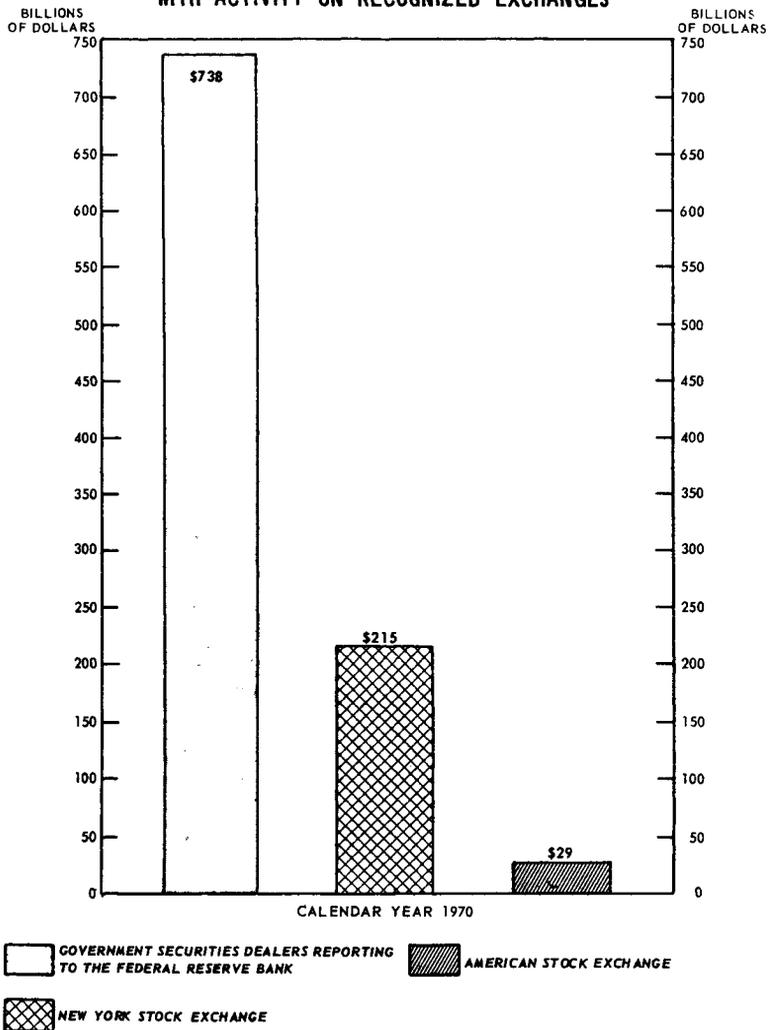
The Federal Open Market Committee has delegated the responsibility for executing its policy for all Reserve banks to the Federal Reserve Bank of New York (Federal Reserve Bank). Each year the Federal Open Market Committee appoints a senior officer of the Federal Reserve Bank to manage the system open market account. The manager maintains a trading desk at the Federal Reserve Bank to handle all purchases and sales of Government securities.

Marketable Government securities are traded daily in an over-the-counter market by dealers in Government securities. Certain dealers, called recognized dealers, are permitted by the manager of the system open market account to trade directly with the trading desk and are expected to respond to the trading desk's needs for buying and selling these securities. This procedure is designed to ensure that dealers admitted to trading have the resources and ability to undertake large volumes of trading.

The number of recognized dealers varies from year to year. As of March 31, 1971, there were 20 recognized dealers, of which 11 were nonbank business enterprises and nine were banks. They form a security market which is the largest in the country in terms of dollar volume and which is heavily vested with the public interest. The market is not regulated by either the Government or a private association.

The volume of purchases and sales by recognized dealers in Government securities increased steadily from \$573 billion in 1966 to \$738 billion in 1970. A comparison of the 1970 volume of Government securities traded with purchases and sales of the New York Stock Exchange and the American Stock Exchange is shown in the following chart.

**TRANSACTIONS REPORTED BY GOVERNMENT SECURITIES DEALERS
COMPARED
WITH ACTIVITY ON RECOGNIZED EXCHANGES**



Because statistical and financial information about the dealer market was scarce, a formal reporting system was established in 1960. The reporting program was aimed at providing current information on the functioning of the market in Government securities to the public, to students of the market, and to market participants, including the Federal Reserve System and the Treasury Department. Reports include, in addition to annual reporting of balance sheet and income data, daily statistics covering securities positions and borrowings and volumes of transactions. No legal or regulatory requirements exist to enforce reporting; the dealers have reported voluntarily.

NATURE OF GAO REVIEW

Our work was done at the Federal Reserve Bank and at business offices of six dealers in Government securities located in New York. The dealers included in our review were selected with a view toward obtaining representation from each of the three types of dealers which are categorized as specialist, bank, and multioperation.

In the case of financial reporting, we reviewed the requirements imposed on dealers by the Federal Reserve Bank instructions. At each dealer's office we obtained reports submitted to the Federal Reserve Bank for the year ended December 31, 1969. We determined whether the figures on these reports were taken from the dealers' books of account or financial statements or whether the amounts in the accounts or statements had to be revised to satisfy Federal Reserve Bank instructions.

In those instances in which revised figures had been reported to the Federal Reserve Bank, we identified the procedures and methods used to make the changes. We reviewed some of these adjustments, calculations, and other transactions to determine whether sound accounting principles and practices were followed and whether the results were reasonably accurate.

For the daily reports, we reviewed the detailed procedures followed by the six dealers to accumulate, record, and report information required by the Federal Reserve Bank. We selected a few transactions and traced them through the dealers' systems to determine whether the transactions had been handled in accordance with dealer procedures, sound trade practices, and Federal Reserve Bank instructions. We observed the preparation of daily reports for one day at each dealer's office and traced the information through the Federal Reserve Bank processes into its computer file.

Our work was done principally through discussions with the Federal Reserve Bank and dealer officials; onsite observations of operations; and reviews of a limited number

of transactions, accounting records, and other data. The cooperation and courtesies extended to us by the Federal Reserve Bank and dealers were excellent.

Our review did not cover the activities of the System Open Market Account.

The confidential nature of the data relative to operations of individual dealers was maintained in accordance with rule 23 of the Joint Economic Committee which places limitations on the disclosure of data obtained from individual dealers.

CHAPTER 2FINANCIAL REPORTS

We found that the financial reports submitted by the dealers had not been prepared in accordance with sound accounting methods. Further, the dealers used different bases in preparing the reports and made substantial errors in compiling the information in the reports. Consequently we have little confidence that these reports provide accurate information on the operations and profits of the dealers as a group. A list of the deficiencies in the reports we examined is included as appendix II.

The deficiencies in the reports we examined occurred primarily because the dealers did not use sufficient care in preparation of the reports and because the Federal Reserve Bank reviews failed to detect them. The inconsistencies in the data contained in reports prepared by the participating dealers are attributable to the wide latitude in reporting practices permitted under the Federal Reserve Bank instructions.

Before describing some of the major deficiencies affecting the reliability of the reports, it is important to mention the factors that complicate dealer reporting. The Federal Reserve Bank instructions provide for submission of reports on a calendar-year basis, whereas seven out of 20 dealers operate their accounting systems on a fiscal-year basis. Their closing of accounts can be at different dates during the calendar year. Thus their normal year-end adjustments are not made for the period covered by the Federal Reserve Bank reports.

Also 14 are engaged in activities other than trading in Government securities and their accounting systems and normal financial statements relate to the entire operations. As a result of both these factors, many adjustments had to be made to the information in their formal accounts to prepare the Federal Reserve Bank reports. It is in this conversion process that most of the problems existed.

INCOME

We found two major problems which affected income--namely, all trading gains or losses were not reported in the right reporting period, and dealers used different methods to calculate unrealized gains or losses.

All gains and losses not reported in the right reporting period

The dealers included in our review used three methods of recording security transactions (1) the commitment basis, recording transactions on the date that the purchase or sale is made, (2) the settlement basis, recording transactions on the agreed-upon date for delivery, and (3) the delivered basis, reporting transactions on the actual date that the securities are delivered. For 1969 the Federal Reserve Bank required dealers to report on a commitment basis in their income statements all unrealized gains or losses on positions as of December 31.

Included in our review were three dealers who were on other than a commitment basis and who did not make the necessary adjustments for reporting. Thus one dealer reported unrealized gains and losses on \$649 million of securities but did not report in that reporting period unrealized gains and losses on an additional \$330 million of securities that should have been included in his computation if it were made on a commitment basis.

The second dealer, with a position of \$313 million, omitted from his computation about \$44 million of securities; the third omitted \$6 million from his calculation on \$54 million of position. In addition, these same dealers did not compute the realized gains or losses on securities which were purchased and sold prior to January 1 but which were not settled until after December 31.

Although the dealers knew that they were required to report on the commitment basis, they did not do so because they said that too much effort was required. The dealers did not provide us with data on what the cost of reporting on the commitment basis would be and we did not make our own study of such costs; however, we believe, with proper planning, the report could be prepared on the commitment basis without an unreasonable amount of effort.

Early in our study, we advised the Federal Reserve Bank of our findings regarding the use of other than the commitment basis of reporting. On their own initiative, bank officials revised the instructions to permit dealers to compute profits on their own accounting bases. We doubt the merits of this revision because it could have a material effect on the reported gains or losses. This would occur when there are large variances in opening and closing positions on a commitment basis which would not be reflected by the dealer's accounting basis.

Further, in the case of interdealer trading, there could be significant transactions lost to the reporting system. For example, if a dealer reporting on the commitment basis sold securities on December 31 to another dealer reporting on the settlement method, these securities would not be reported in the positions of either dealer.

Different methods used to calculate unrealized gains and losses

The Federal Reserve Bank also instructs the dealers to compute their unrealized gains or losses on year-end positions at market value and allows the dealers to choose their own methods of determining market values.

The dealers whose records we reviewed used four methods of determining market values for their positions. Three dealers used their own judgment of prices. One used published composite prices; one used last sale; and one dealer used a combination of his own judgment and price quotes of another dealer. Thus the same class of securities held by each dealer may be valued at different prices for computing unrealized gains or losses.

When we advised the Federal Reserve Bank of this problem, they again issued new instructions requesting dealers to use the Federal Reserve Bank composite closing quotations. This, however, did not fully resolve the problem because closing quotations only include securities issued by the Treasury and do not include securities issued by other Government agencies. Agency securities can represent significant sums. For example, one dealer's position included \$121 million in Government agency securities.

EXPENSES

The major problems in reporting expenses were the numerous errors made by dealers in allocating them and the different methods of accounting for them.

Questionable allocations

The Federal Reserve Bank instructs dealers to allocate expenses between their Government operation and other operations. The five dealers who had to make allocations attempted to comply with instructions; however, they did not follow sound accounting practices or were not careful in making distributions.

In pooling their expenses for allocation, some dealers did not follow the accepted practice that there must be some relationship between the expenses and the operation to which they are allocated. For example, one dealer overstated his reported expenses by about \$900,000 because his pool included commissions and dividends not related to Government operations and interest on partnership capital, which is not an expense but a form of profit distribution. Another dealer did not reduce his reported expenses by \$84,000 because he did not allocate to other operations the cost of services performed for those other operations by his Government operations.

Also Government securities are used to borrow funds for all of the dealers' operations. In allocating the related interest expense, two dealers charged their Government operations with the total interest on borrowings made with Government securities without regard to how much was relatable to non-Government operations. Since interest on borrowed funds is the dealers' largest expense, this could have a material impact on reported net income. To illustrate the impact that this allocation can have when done properly, one dealer who did allocate such interest costs, instead of reporting all of it under Government operations, showed only \$8.1 million out of a total of \$10.3 million as relatable to Government operations.

In addition, dealers used various bases for making allocations. One dealer arbitrarily allocated administrative

expenses on the basis of the number of people employed in Government operations to the total number employed and did not establish that this ratio was commensurate with the benefits obtained by the Government activities. Another dealer merely had his staff estimate the amount of expenses to be allocated to Government operations without any supportable basis except judgment.

Different methods of accounting used in reporting

The Federal Reserve Bank instructions are silent as to whether reports should be prepared on an accrual or cash basis; this is one of the reasons for the lack of uniformity in reporting. Three dealers prepared their statements on an accrual basis and three dealers submitted their statements on a combination of accrual and cash basis. For example, one dealer reported interest earned, prepaid insurance, and interest on borrowed funds on an accrual basis but reported general and administrative expenses on a cash basis. We did not make a study to determine the difference in profit and loss that would result from the use of the accrual basis for general and administrative expenses; however, in view of the size of such expenses, we believe the difference could be substantial.

Other

The following paragraphs illustrate other questionable methods employed by dealers in the preparation of financial reports.

Some dealers' Government securities positions were financed with funds borrowed from their other operations. The Federal Reserve Bank requires these dealers to apportion a part of these funds as interest free because they represent allocated capital. Interest is includable on the remaining portion as part of reportable expenses.

One dealer has been using an estimated amount of \$7.5 million since 1965 to represent his allocated and therefore interest-free capital and has been reporting the interest on the remainder as expense. We were told that this \$7.5 million estimate was based on a comparison of the

relationship between capital and total Government positions of several other New York City dealers. We believe that more exact methods of determining allocated capital should have been employed.

Another dealer made no allocation in 1969 and reported interest expense on the total borrowings. He reported interest-free borrowings in 1965 of \$5 million. Assuming the same apportionment for 1969, the reported interest costs for borrowed funds would have been reduced by about \$429,000.

The dealers told us that they could not make a realistic apportionment unless the Federal Reserve Bank gave them more guidance. These same dealers, in computing interest on funds borrowed to finance Treasury bill positions, used par value of the securities as a base rather than the amount borrowed. In addition, one of these dealers used the wrong interest rate to make the calculations. As a result, the interest expense reported by one dealer was \$175,000 too high whereas the other reported a figure that should have been \$9,000 higher.

Also, the Federal Reserve Bank instructs dealers to report profits both before and after income taxes and specifically states that income taxes are not to be included as an expense. We found that three dealers reported correctly. One of the remaining three dealers included the New York City income tax as an expense, and two dealers ignored the city tax altogether in preparing their reports.

NET WORTH ALLOCATION

The Federal Reserve Bank requires nonbank dealers to estimate net worth allocable to Government activities for use in its profit studies on return on capital. The methods used for allocation did not appear to provide reasonable results because the Federal Reserve Bank has not given dealers suitable guidance.

A Federal Reserve Bank study in 1967 indicated that it was aware that dealers were having problems and were using various methods to allocate net worth. The report also discusses various concepts of net worth allocation and the difficulties encountered in applying them. It was silent, however, as to which method would be preferable or what guidelines should be followed.

The dealers are apparently still having problems in complying with this requirement and are still using various methods in preparing the reports. In some instances the results appeared questionable. The following examples illustrate some of these conditions.

In determining the amount of net worth used for his position in Government securities, one dealer included \$4 million of Government securities held for his own investment purposes plus \$2 million of Government securities deposited with clearing corporations for handling other than Government transactions. The \$6 million should have been treated as applying to his other operations since these funds were not used in maintaining his position.

Another dealer using a ratio of positions to all company assets reported a net worth allocation to Government operations of \$2.4 million. This dealer did not retain the details of his calculations. We used the method he described in his report to the Federal Reserve Bank to compute an allocation of \$1.9 million as applicable to Government operations, or \$500,000 less than reported. Although the dealer agreed with our computation, he was unable to determine what caused the difference.

In allocating net worth, a third dealer used a ratio of Government securities to his total position. This method

appears inequitable because considerably less of the company's own capital is needed to maintain Government securities positions since

- large positions of Government securities need less borrowings owing to their margin requirements which range from less than 1 to less than 6 percent, whereas 25 percent margin is necessary on corporate bonds and 65 percent for stocks and
- the low amount of positions kept by the dealer's underwriting activities (which handles other than Government issues) required substantial resources to operate.

Under such circumstances, a disproportionate amount of net worth can be allocated to the Government securities operation.

REVIEW OF FINANCIAL STATEMENTS

The Federal Reserve Bank reviews of dealer reports were not effective in ensuring that the reported financial data was reasonably reliable because the group responsible for such reviews did not

- visit dealers to examine the supporting data and review report preparation practices,
- have staff with professional accounting expertise, and
- have the authority required to obtain dealer cooperation.

Among its other duties, the Market Statistics Division of the Federal Reserve Bank is responsible for processing, reviewing, and distributing dealer reports. Its reviews consisted essentially of checks for mathematical accuracy, completeness, and consistency with other reports. They told us that they also made certain analyses of the financial data but did not rely too heavily on them because they felt that the information was unreliable. These reviews were done at the Federal Reserve Bank. According to the Market

Statistics Division, visits were not made to the dealers' offices to examine into the reports in more depth because it did not have the authority to do so.

Another problem in making such reviews was that the Market Statistics Division did not have any professional accounting expertise on its staff. The Market Statistics Division had about 32 individuals on its staff comprising 11 professional and junior economists, 16 statistical clerks, and five typists and messengers. About eight of these staff members were assigned to processing, reviewing, and distributing the financial reports.

The Market Statistics Division had no authority to correct errors found in dealer reports or to enforce improvements in dealers' reporting practices.

If the staff of the Market Statistics Division obtained professional accounting expertise and were permitted to review dealers' accounting procedures at the site, they could more effectively identify errors and inconsistencies in the dealers' reports. They could also encourage dealers to make changes and improvements in the data reported.

CHAPTER 3DAILY STATISTICAL REPORTS

The Federal Reserve Bank requires the dealers to submit daily the following statistical information.

<u>Type of report</u>	<u>Description</u>
Positions	The amount of securities held for trading valued at par by type of security
Borrowings	The amount borrowed to maintain positions by source and type of security
Volume	The amount of sales and purchases at par value by source and type of security

We found a marked contrast in the procedures and controls covering the processing and reporting of transaction data when compared with those used for reporting financial information. The transaction reports usually came directly from the dealers' day-to-day operating systems. The need to have up-to-date and accurate data for trading operations undoubtedly had an influence on the reliability of those systems.

Although we found that two dealers had reported certain repurchase agreements incorrectly, the Federal Reserve Bank told us that in two instances the incorrect data had not materially affected the data as a whole and in another the Federal Reserve Bank had issued corrected instructions for future reporting. On the basis of our observations, it seems that the dealers have adequate internal control procedures for processing daily transactions. Accordingly we believe that the information furnished to the Federal Reserve Bank in the aggregate is reasonably reliable.

The following paragraphs illustrate the errors found.

The Federal Reserve Bank and the dealers regard repurchase agreements as loans secured with collateral. The then-current instructions required that repurchase agreements be reported as borrowings at the actual amount borrowed. We found that two dealers were valuing their outstanding repurchase agreements at par value of the securities pledged as collateral instead of at the amount of funds borrowed. As a result, these dealers were overstating from 3 to 4 percent the amount borrowed in the daily transaction report. Although this practice was contrary to instructions, Federal Reserve Bank officials said that they were aware that some dealers were doing this but they believed that the aggregate borrowing statistics were only slightly affected by it.

We found also that one of the dealers discussed in the preceding paragraph had, in accordance with a 1966 instruction, reported a certain type of repurchase agreement as a sale. Although the total amount was substantial, about \$148.6 million, the transactions occurred rather infrequently. After discussing this situation with Federal Reserve Bank officials, they rescinded the 1966 instruction and advised the dealer to follow then-current instructions.

CHAPTER 4OTHER OBSERVATIONS

During our review, we noticed conditions which we consider important to the subject of the review and which may be of interest to the Committee. These conditions deal with problems in analyzing net income, improved disclosure of matters that would significantly affect the reports, and the lack of use made of the financial reports.

PROBLEMS IN ANALYZING NET INCOME

Except for information relating to net profit and net worth, data permitting analysis of the profitability of market operations in Government securities was limited. This situation stemmed essentially from the Federal Reserve Bank's inability to obtain information on certain sources of income and factors affecting profits.

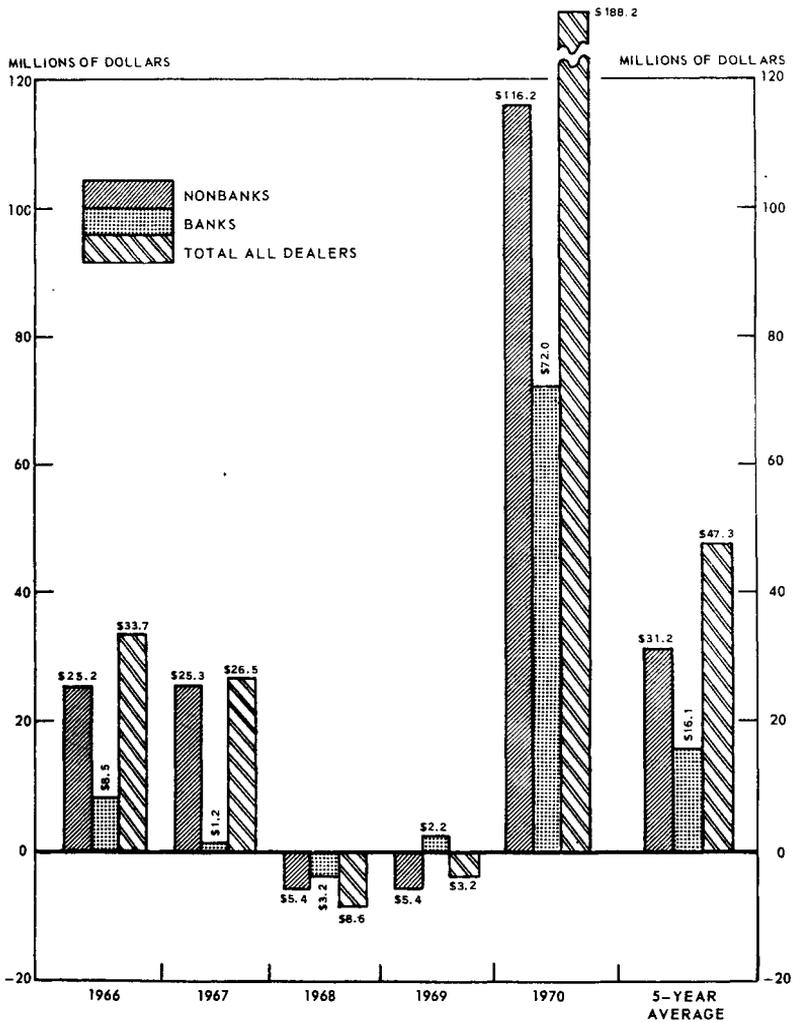
For the period 1966 through 1970, the aggregate of earnings reported by all dealers, before taxes, ranged from a loss of \$8.6 million in 1968 to a net profit of \$188.2 million in 1970. The chart on the following page shows the reported profits for each year and the 5-year average.

In discussing the difference in the 1969 and 1970 figures, a Federal Reserve Bank official told us:

The sharp swing in dealer earnings between 1969 and 1970 stemmed from the turnaround in interest rates. In 1969 interest rates were rising and they reached record levels. Dealers maintained relatively small positions and had to finance them at negative yields. In 1970 interest rates declined and dealers increased their positions in anticipation of further reductions. Also the drop in short-term money market rates outpaced declining yields on long-term securities and allowed dealers to finance their positions at favorable rates. The trend toward higher prices enabled the dealers to earn substantial trading profits.

A more detailed analysis of these factors was not possible because the net income information obtained by the

DEALERS IN GOVERNMENT SECURITIES REPORTING TO THE FEDERAL RESERVE BANK OF NEW YORK DEALER PROFITS (BEFORE TAXES)



Federal Reserve Bank did not provide, in all cases, for dealers to segregate trading profits from interest earned on Treasury bills. Such information is furnished only if the dealer normally makes such a breakdown. Although bills constitute the largest volume of securities sold, three of the six dealers that we visited did not separate interest earned from trading profits but lumped these factors together. Thus the extent of trading profits in the aggregate was undeterminable.

An analyst of the Federal Reserve Bank stated that another important factor influencing profits was the interest paid on funds borrowed by the dealers to finance their positions. We noted that in 1970 the Federal Reserve Bank entered into about \$34 billion worth of repurchase agreements with nonbank dealers. The Federal Reserve Bank enters into these transactions in performing its function of maintaining a flow of credit and money. The interest rate paid by the dealers on these borrowings is almost always less than if they obtained the funds from other sources.

For example, during July 1970, the Federal Reserve rate was as much as 2 percent less than the New York City bank loan rates for dealers. Thus these transactions enable dealers to finance their securities at lower costs. Financial data that would readily allow assessment of these transactions on nonbank profits is unavailable.

The rate of return reported on net worth by the nonbank dealers for the 5-year period is shown below.

Rate of Return on
Net Worth Allocated to
Government Securities Operations

<u>Year</u>	<u>Net income</u> <u>(millions)</u>	<u>Net worth</u> <u>(millions)</u>	<u>Percentage</u> <u>of return</u>
1966	\$ 25	\$ 76	33
1967	25	97	26
1968	-5	101	-5
1969	-5	104	-5
1970	116	129	90
5-year average	31	102	31

We obtained profit and net worth data on the profitability of other industries and operations. The First National City Bank of New York monthly economic letter of July 1971 showed composite rates of return on net worth, after taxes, for more than 3,700 leading corporations. These included manufacturing, transportation, and financial institutions (commercial banks, investment trusts, etc.). To put the economic letter figures on the same basis as those of the dealers, we adjusted the profits, after taxes, to arrive at profits, before taxes, by assuming a tax rate of 50 percent. The economic letter figures as adjusted are shown below.

	Percent of return on net worth	
	<u>1969</u>	<u>1970</u>
Manufacturing	25	20
Transportation	8	2
Financial	12	13
Composite	21	18

We also obtained from the New York Stock Exchange reported statistics covering the financial results of member firms. This information showed that more than 300 firms made a return on net worth, before taxes, of 16 percent in 1969 and 19 percent in 1970.

A General Accounting Office profit study showed that, for 74 large defense contractors in 1969, the average return on net worth, before taxes, was 17.4 percent on work for the Department of Defense, 24.8 percent on work for other defense agencies and 20.4 percent on commercial work.¹

These figures are shown not for the purpose of assessing the reasonableness of earnings by the dealers but merely to provide some information on how they compare with other business enterprises in the economy.

¹Defense Industry Profit Study, B-159896, March 17, 1971.

NEED FOR REFINING FINANCIAL REPORTS

In addition to the incomplete disclosure of income data, we observed:

1. Federal Reserve Bank instructions did not require assertions to the effect that financial statements were or were not prepared on a basis consistent with that of the preceding year. In our opinion, such an assertion should be required to disclose any accounting procedural changes that would produce results differing materially from past years.

2. Some dealers adjusted their security positions each month to market values and record the unrealized gains or losses in the income accounts. Under these circumstances, the more acceptable method of financial data presentation requires that disclosure be made of the amount of unrealized profit which accumulated over the year and is still in the position values at year-end. Such disclosure is not specifically required by the Federal Reserve Bank.

USE MADE OF REPORTS

The expressed doubts about the reliability of the financial reports have limited their usefulness. We understand that the daily reports were meaningful to officials of the Federal Reserve Bank.

Financial reports

We found practically no use made of the financial reports and therefore discussed this matter with officials of the Federal Reserve Bank, the Federal Reserve Board, and the Treasury Department. Some of their comments follow.

An official of the trading desk, Federal Reserve Bank, told us that the financial reports were not necessary to its operation. Such information, however, could be useful to observe broad trends in the market if it were not for the problems in allocating income, expense, and net worth.

A Federal Reserve Board staff member stated that the reports were used for (1) identifying changes in dealer operations, (2) evaluating dealer profits, and (3) determining

those dealers that may have financial difficulties. He added that the reports would be more useful if the allocation methods for expenses and net worth were improved.

Treasury officials were concerned with whether there were enough dealers to handle the volume of trading and were also interested in such other matters as dealer profits. They believed that the reports were necessary but that they could be more useful if improved.

We also found that the financial data, in the aggregate, was not regularly distributed to the Congress or to the public. An official of the Federal Reserve Bank told us that this was not done because the reports were considered unreliable and therefore meaningless.

Daily reports

Each day the trading desk at the Federal Reserve Bank receives position data for each dealer and aggregate data on positions, dealer borrowings, and volume of transactions to assist it in its open market operations. In addition, selected data in the aggregate is sent daily to all the Federal Reserve Bank presidents, to the Federal Reserve Board, and to the Treasury Department.

Only aggregate statistics are released to the public through weekly press releases and the monthly Federal Reserve Bulletin. The volume of transactions is publicly released weekly and position and borrowings after a 4-week time lag.

Federal Reserve Bank officials who operate the trading desk have told us that the data is useful for several purposes. The data is used to determine the amount of securities available for purchase from dealers and to determine the amount of money borrowed and the source of borrowings.

CHAPTER 5SUGGESTED CORRECTIVE MEASURES

Considering the highly sensitive nature of the Government security market operation and how little was known about it in 1960, we believe that the progress made toward developing and operating a financial and transaction reporting system merits commendation. The fact that this progress was made without regulations and achieved through the Federal Reserve Bank and dealer cooperation also warrants recognition.

Even so, we believe that our findings show a need for the Federal Reserve Bank and dealers to improve the reliability and usefulness of the financial data accumulated under the reporting system. This will require special effort by them if improvement is to be achieved. In the remainder of this chapter, we are suggesting some corrective measures that we believe could be taken by the Federal Reserve System to achieve appropriate improvements.

STRENGTHENING CONTROLS OVER
PREPARATION OF REPORTS

In chapter 2 we pointed out major problems that were encountered: (1) all income was not being reported for the accounting period because some dealers were not on a commitment basis and (2) some dealers reported some accounts on an accrual basis but reported others on a cash basis. It is generally recognized that the accrual method of accounting more accurately shows the financial position of a concern and more precisely measures the results of operations for specific periods. Accordingly we believe that the financial reports should be prepared on an accrual basis if a significant difference might result.

Another problem discussed in chapter 2 was the reasonableness of expenses allocated to the Government securities operation. The inequities found were mostly attributable to mistakes made by the dealers and the need for more specific guidance by the Federal Reserve Bank. We believe that the following steps could be taken by the Federal

Reserve System to build a greater degree of assurance into the reporting system.

- Develop criteria for the dealers to follow in allocating expenses with special emphasis on the suitability of the basis used to allocate costs and the relationship of expenses to Government securities operations.
- Require dealers to retain the working papers supporting such items as adjustments, allocations, and calculations in preparing reports so that questions involving the data submitted can be properly resolved.
- Establish methods for increasing awareness on the part of top management officials of the dealers that complete and accurate data is to be provided.
- Establish and require dealers to use uniform quotations to determine market value of Government agency securities.

Chapter 2 also covers the question of obtaining realistic allocations of net worth which has been a continuing problem. Essentially there is a lack of guidance in this area. We believe that problems in such allocations could be overcome through the development of specific criteria on the method to be used in allocating net worth.

IMPROVING REVIEW FUNCTION

To strengthen the Federal Reserve Bank review function we believe that

- the Market Statistics Division should obtain professional accounting expertise,
- the review procedures of the Market Statistics Division should be modified to provide for examinations of financial data and supporting workpapers at the dealers' offices, and
- the authority of the Market Statistics Division could be broadened to provide for visits to dealers' offices and enable it to make changes necessary

to improve the accuracy and usefulness of financial reports.

REFINE FINANCIAL REPORTS

In chapter 4, we show the advantages that can be gained by refining the financial reports particularly with respect to more complete disclosure of income data. The following steps could be taken to provide for better reporting.

- Require dealers to segregate Treasury bill trading profits from interest earned in the net income analysis.
- Require dealers to indicate whether reports were prepared on a basis consistent with that of the prior year. If changes in accounting procedures were made, the dealer should describe the nature of the change and the effect on the data.
- Require dealers to disclose the unrealized gains and losses for all Government securities using cost as a base. The balance sheet should show the amount of unrealized gain or loss included in reported positions.

DISTRIBUTION OF AGGREGATE REPORT DATA

To ensure distribution of financial data to the Congress and the public, we believe that consideration should be given to inclusion of the dealers' aggregate data in the annual report of the Federal Reserve Board. To accomplish this, we suggest that the Federal Reserve Bank establish reporting dates to coordinate with the date of the annual report.

AGENCY COMMENTS

We discussed the report with officials of the Federal Reserve Bank who gave us their informal comments. Although they agreed with our findings and conclusions, they told us that the Informal Treasury-Federal Reserve Steering Committee, which has overall responsibility for the reporting system, would have to decide on what corrective action would be taken.

APPENDIXES

APPENDIX I

WRIGHT PATMAN, TEX., CHAIRMAN
 RICHARD BOULINE, MD.
 HALE BOGGS, LA.
 HENRY B. REUSS, WIS.
 MARTHA W. GRIFFITHS, MICH.
 WILLIAM B. MOORHEAD, PA.
 WILLIAM B. WYONALL, N.J.
 W. E. BRACK CO., TENN.
 BARNER B. CHAMBLE, JR., N.Y.
 CLARENCE J. BROWN, OHIO
 JOHN R. STARK,
 EXECUTIVE DIRECTOR

Congress of the United States
JOINT ECONOMIC COMMITTEE

(CREATED PURSUANT TO SEC. 5(a) OF PUBLIC LAW 354, 75TH CONGRESS)

WASHINGTON, D.C. 20510

WILLIAM PROCHORE, WIS., VICE CHAIRMAN
 JOHN SPARKMAN, A.A.
 J. W. FULBRIGHT, ARK.
 HERMAN E. TALMADGE, GA.
 STEWART STEWARTSON, MD.
 ABRAHAM RIBICOFF, CONN.
 JACOB K. JAVITS, N.Y.
 JACK WILLEM, IOWA
 LEO B. JORDAN, IOWA
 CHARLES H. PERCY, ILL.
 JAMES W. KNOWLES,
 DIRECTOR OF RESEARCH

May 1970

The Honorable Elmer B. Staats
 Comptroller General of the United States
 Washington, D. C.

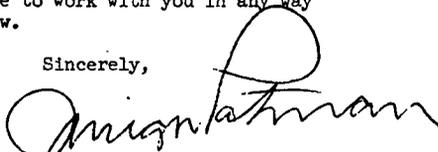
Dear Mr. Staats:

Eleven years ago, at my request, the staff of the Joint Economic Committee developed a set of reporting forms and accounting standards to use in obtaining information on the operations of the dealers who make a market in Government securities. At that time there were seventeen such dealers. The results were published by the Committee in 1960 in a pioneering staff study of this market. Subsequently a system of regular reporting on this market was developed by the Federal Reserve System in cooperation with the dealers. This system now produces a regular flow of data about transaction in the market and on revenues, expenses, and profits of dealers, both bank and nonbank.

Now that this system has been operating for several years, it would seem appropriate to review the basic accounting standards that are employed to make sure that these are in accord with the best practices. This would insure that we could have confidence in the data, particularly as to the profits of the dealers. With this aim in view, I am attaching a set of the forms and instructions used by the Federal Reserve Bank of New York in operating this system of reporting and I request that your accounting experts go over this system and advise me as to whether or not: (1) the accounting practices are in accord with the best accounting standard; and (2) such a system is likely to afford the public and our Committee an accurate picture of the operations and profits of these dealers as a group.

Mr. James W. Knowles, Director of Research for the Joint Economic Committee, has been involved with this system from the beginning in 1959, and is available to work with you in any way needed in the course of your review.

Sincerely,



Wright Patman, Chairman

APPENDIX II

LIST OF FINANCIAL REPORT DEFICIENCIESBY TYPE AND PRIMARY CAUSEStatements of Financial Condition

	<u>Primary cause</u>
1. Adjustment of securities positions from the dealer's basis of accounting to the commitment basis was made incorrectly. (2) ¹	D ²
2. Various methods were employed for determining the market value of securities positions. (6)	F
3. Net worth allocated to Government securities activities was not adequately supported. (1)	D
4. Securities borrowed and the offsetting liability were not reported. (1)	F
5. Liability for outstanding repurchase agreements reflected par value of the securities instead of actual money borrowed. (1)	D
6. Securities purchased but not yet received understated due to a footing error. (1)	D
7. Accrued interest receivable and accrued interest payable were inaccurate. (2)	D
8. Nonreportable securities were included in financial statements. (2)	D
9. Securities sold but not yet delivered were improperly stated. (2)	D
10. Securities positions were overstated. (2)	D
11. Repurchase agreements were improperly classified as to maturity and type of security. (2)	D

¹See page 34.

²See page 35.

APPENDIX II

	<u>Primary cause</u>
12. All contingent liabilities were not reported. (1)	D
13. Required explanations of data were not submitted. (2)	D
14. Positions in agency securities were erroneously classified as "other securities." (1)	D
15. The reported increase in net worth was not accurate. (1)	D
16. Related asset and liability accounts were offset even though the Federal Reserve Bank instructed otherwise. (1)	D

Net Income Analysis

17. Trading profits were not reported on the commitment basis, as required by Federal Reserve Bank instructions. (3)	D
18. Unrealized gains or losses not reported in the right reporting period. (1)	D
19. Unrealized gains on Government securities including Treasury bills were not properly classified. (1)	D
20. Unrealized loss was erroneously reported as unrealized gain. (1)	D
21. Income was not reported on a calendar-year basis as required by the Federal Reserve Bank. (1)	D
22. Certain interest income was offset against interest expense. (3)	D
23. Expenses on certain transactions were offset against interest income instead of being reported separately as required. (1)	D

APPENDIX II

	<u>Primary cause</u>
24. Required explanations of data were not submitted. (2)	D
25. Income on Treasury bills was overstated. (1)	D
26. All income items were not reported. (1)	D
27. Cost of borrowed funds was overstated because interest was on the par value of Treasury bills instead of the discounted value. (2)	D
28. Unrealistic interest rate used for calculating the cost of own bank funds used. (1)	D
29. Miscellaneous income items were incorrectly classified. (2)	D
30. Miscellaneous interest expense was inaccurately reported. (3)	D
31. Expenses included certain items not applicable to Government securities activities. (2)	D
32. No schedule supporting expense allocations was submitted. (1)	D
33. Interest-free dealer department capital estimate was unrealistic or not estimated. (2)	D
34. Local income taxes were treated inconsistently. (6)	F
35. Interest expense was overallocated as a result of including costs incurred in financing other than Government securities activities. (2)	D
36. Data submitted was not fully on an accrual basis. (3)	F
NOTE: Figures in parentheses () indicate the number of dealer errors.	

TABULATION OF DEFICIENCIES

	<u>Number of</u> <u>deficiencies</u>	
	<u>Type</u>	<u>Instances</u>
D = caused primarily by erroneous dealer procedures.	32	51
F = caused primarily by weaknesses in Federal Reserve Bank instructions, guidelines, etc.	<u>4</u>	<u>16</u>
	<u>36</u>	<u>67</u>

Mr. STAATS. If Congress asked us to make such a review and we could get the cooperation of the Board, we would be very happy to undertake such a review.

Mr. STANTON. Mr. Staats, the last time this subject came up in any depth was in 1967. Chairman Robertson at that time testified—and I have his testimony—and this was in regard to an answer about outside firms selected by the Federal Reserve Board. They have included Arthur Anderson & Co., Price Waterhouse & Co., and most recently, Lybrand & Ross Bros. and Montgomery.

I am not familiar with all these auditors. Are you familiar with these companies?

Mr. STAATS. We are familiar with all these organizations, Mr. Stanton, and we work with them almost daily, and certainly we are in touch with them on various matters all the time, and we are quite familiar with them.

We are also, I think, quite familiar with some of the problems that these firms have.

Mr. STANTON. They have problems in getting cooperation?

Mr. STAATS. They run into difficulties, too. There are two major efforts going on with respect to the entire public accounting profession because of some of the problems that they have had. They have recently established a financial accounting standards board, because they had not been able to make adequate progress in developing accounting principles and standards.

The American Institute of CPA's has a committee that is about to report on what should be the kind of audit reports made in the first place. Some public accounting firms go well beyond our alternative 1 and make studies of the type that are embraced in alternative 2, and they render what they call management letters, letters to management suggesting improvements in the management of procedures, the processes, of the corporation. More and more of the public accounting firms are doing what is in both 1 and 2 of the type of audit that we are suggesting as possibilities here to this committee.

Mr. STANTON. Your main concern is you do think on 1 and 2 alternatives, you can do a service to the Congress in perhaps pointing out deficiencies and so forth? That is your main emphasis?

Mr. STAATS. Yes, indeed.

Mr. STANTON. Thank you very much.

The CHAIRMAN. Mr. Reuss?

Mr. REUSS. Thank you, Mr. Chairman, and thank you, Secretary Carlock and Mr. Staats, for your excellent presentations.

Let me say you have both persuaded me. I think the Treasury ought to be entitled to, and the GAO ought to get, the authority that is believed needed. And if the Federal Reserve makes a strong case tomorrow for the \$60 million for additional buildings, I believe I could support the whole bill, although I think Mr. Staats has some excellent improvements in the GAO section.

Mr. Staats, I would like to ask you a bit about the Federal Reserve Open Market Committee purchases. And here I am referring in large part to your excellent report of October 6, 1971, to Chairman Patman.

Check me on the following arithmetic. I believe the Federal Reserve System's holding of Federal securities is now on the order of \$73 billion?

Mr. STAATS. \$75 billion.

Mr. REUSS. \$75 billion.

And I think you also testified just now that the annual turnover in sales and purchases by the Open Market Committee was something like \$730 billion, about 10 times the amount of the holdings. Is that right?

Mr. STAATS. The figure I gave you was \$738 billion. That was in 1970.

Mr. REUSS. Your 1971 report that I also referred to also indicated that the profits of the dealers in U.S. securities over a 5-year period prior to your report averaged \$47 billion a year, and in 1 year, 1970, it came to \$188 billion. Is that correct?

Mr. STAATS. I believe that is correct.

Mr. REUSS. Of course, that included transactions in addition to Open Market Committee transactions, I assume?

Mr. STAATS. I believe that is correct.

Mr. REUSS. You used that figure as showing that the banks and nonbanks which trade in Government securities do rather well making, for a 5-year period, a return on net worth of 31 percent, compared to 2 percent in 1970 for railroads, 20 percent for manufacturing, 13 percent for financial institutions. So they are doing rather well.

Mr. STAATS. It was spotty from year to year, but that was the overall for the period we looked at.

Mr. REUSS. Is there any way which this committee can now have available to it, pursuant to its constitutional duty to coin money and regulate the value thereof, information to determine whether the Open Market Committee, is churning its portfolio, doing what the SEC would stop an investment trust-affiliated broker from doing, overbuying and overselling?

I do not have the slightest idea whether this is so or not, but it does seem to me like a tremendous beehive of activity. After all, the Joint Economic Committee's advice to the Fed is, create new money at the average rate of 4 percent a year.

Well, if all they did was to follow the Joint Economic Committee, that would be a 4-percent turnover. You are actually getting a 1,000 percent turnover.

Is all this activity really necessary?

Mr. STAATS. I do not believe I have any definite views about that point.

Mr. REUSS. That is the sort of thing which an economy and efficiency audit of the third category in your statement might throw some light on, is it not?

Mr. STAATS. The third type, yes, sir.

Mr. REUSS. Thank you very much.

The CHAIRMAN. Mr. Blackburn?

Mr. BLACKBURN. Thank you, Mr. Chairman.

I, too, want to welcome Mr. Staats and Mr. Carlock to the committee. It is always a pleasure.

Mr. Staats, as I interpret your three-tier audit, the first two go more toward the mechanics of the operation under the Federal Reserve System, the efficiency of its operation. The third proposal would go to question the judgment decisions, perhaps, of the Board of Governors.

Now, am I right?

Mr. STAATS. On an after-the-fact basis, not before the fact.

Mr. BLACKBURN. I find myself with some conflicting views in my own mind about the proposed bill before us. I feel that any public body should be answerable to the public, and since you are our auditing firm for the Congress, we are the ones that have to respond to the public ourselves. I feel: what is wrong with having our arm go in and investigate an independent agency of Government?

On the other hand, I find myself wondering, would we be infringing on the independence of the Fed if we find that an arm of the Congress could, after the fact, make justifiable criticisms about judgment decisions which, at the time they were made, might have appeared to be justified. This is one question that I have.

Mr. STAATS. Well, I do not really see how audits of the type 1 or 2 really would raise that issue. With respect to the third type, I would be more willing to accept the argument that has been made. And it is perfectly possible that Congress might not wish us go beyond 1 or 2. Or if it wanted to go beyond that, then safeguards could be written in in whatever way was necessary to give the Board assurances on this point.

I certainly would not be one to want to challenge the kind of independence that the Board has had. I certainly would not want to question the need for preserving in a most careful way the sensitivity of some of the information which is available. I am not implying by that that you cannot trust the GAO; I think you can. We have handled some of the most sensitive information that there is in the Government, and so far, I do not think we have been the source of any leaking.

Mr. BLACKBURN. Well, along the lines of the whole question of the operation of a banking system, the question I have had in recent years comes to my mind as to whether or not our commercial banks have a vested interest in heavy Federal deficits, in light of the profits that they make on their Treasury investments.

Mr. STAATS. I would not want to speculate on that.

Mr. BLACKBURN. Would that be the sort of thing we would find out with a phase 3 audit?

Mr. STAATS. No. I think we would be interested, though, for example, in phase 3 as to the adequacy of a bank examination. That would be the type of thing we would be interested in.

Mr. BLACKBURN. Now, I am not talking about phase 3 of economic stabilization.

Well, thank you, Mr. Staats. I appreciate your testimony.

I have no further questions, Mr. Chairman.

The CHAIRMAN. Mr. Ashley?

Mr. ASHLEY. Thank you, Mr. Chairman.

On page 7 of your statement, you indicate that H.R. 10265 would authorize the General Accounting Office to audit only the Board of Governors and the Federal Reserve banks and branches, not the operations of the Federal Advisory Council and the Federal Open Market Committee.

I would ask if this would reflect a change of view on your part, Mr. Chairman, that, namely, the Advisory Council and the Open Market Committee should not be subject to audit, or whether it should be included?

The CHAIRMAN. Yes. It is all right, I think.

Mr. ASHLEY. I wonder if there was anything deliberate in the exclusion in your bill of the authority of the General Accounting Office to audit the operations of the Federal Advisory Council and the Open Market Committee?

The CHAIRMAN. Well, I did not understand the bill excluded the Open Market Committee. The Open Market Committee is the most important thing about the Federal Reserve System.

Mr. ASHLEY. That seems to be the testimony of Mr. Staats in his evaluation analysis of the bill.

Getting, Mr. Staats, to the judgmental factors that Congressman Blackburn expressed interest in, I just wonder what would be involved in an audit, say, of the Open Market Committee?

It seems to me that the operations of the open market committees can certainly, in large measure, on the phase of the business cycle, the extent to which monetary policy, for example, is being relied upon to curb inflation, perhaps because of failure of fiscal policy to act as an antiinflationary brake—does this kind of judgment not get extremely political, in your view?

Mr. STAATS. Well, I do not entirely separate politics from economics, and it is a very difficult line.

Mr. ASHLEY. I am sorry. You say you try to separate economics from politics?

Mr. STAATS. No. I am agreeing with you that it is a difficult line to draw. But I think it can be drawn; the economists attempt to draw this line all the time.

And we would be concerned, I would think, more here with the processes by which those judgments were made rather than whether or not they made the right decision at the right time. This would seem to me to be what we would be concerned about. We are making these kinds of judgments in other cases. I believe we have been able to separate out the politics from the program results that we think have been achieved.

Mr. ASHLEY. So what you are saying is that you would go to the methodology of the decisionmaking. Well, you say that that is done in other cases. I think that would be enormously difficult with respect to the operations of the open market committee and the assessment as to whether or not, in a given situation, the Federal Reserve is doing the right thing in terms of monetary policy.

I do not quite see how you could develop a set of criteria or methodology in making your determinations and recommendations.

Mr. STAATS. Well, I am obviously not in the position to give you a blueprint here today, because the law has not been enacted, and we have not been in a position where we have the information to give us a basis for really a full answer to your question. And I do not see how we could, really, until we have more information available to us than we have today, because that information just is not available.

Mr. ASHLEY. Well, we have to compare things a little bit. We know that the Federal Reserve historically has felt it necessary to make use of monetary policy as a last resort, a final weapon against inflation, when, for example, there is an unwillingness on the part of the executive branch and Congress to consider in a timely fashion the increase of

taxation, which also tends to thwart demand pressures or to curtail spending.

Would it be possible to develop criteria or methodology for assessing the fiscal side as well as the monetary side?

I do not think it would. I think you would have a terrible time doing that. So what I am saying is, I do not think it is a combination of, at the present time and the past periods, demand pressures. It has been a judgmental evaluation on the part of the Fed as to what kind of combination of tight money, high interest rates, they feel in combination will act as a brake on the economy. Is that not so?

Mr. STAATS. That is true. But that is also true with respect to other agencies of the Government who participate in economic programs or loan programs, for example, Federal credit operations. All of these represent programs which are affected by and affect the economic cycle. We are talking here, I think, about something that is not completely unique to the Federal Reserve Board. But I grant you that it is a very difficult area to draw a judgment.

Mr. ASHLEY. But you say out of this can come a judgment on the part of the General Accounting Office that competes with that of the Federal Reserve. Because it seems to me that what we did was to establish in 1913 a Federal Reserve in a relatively independent capacity so that it could arrive at decisions without being subject to pressures of a political nature.

Mr. STAATS. It seems to me, though, that this committee and—not the GAO—but this committee has responsibility for making a judgment as to how well the Federal Reserve Board has carried out its responsibilities. If this committee does not have that responsibility, I do not know who does.

Mr. ASHLEY. Well, I am not shirking responsibility. But I am saying we decided, and it certainly is our responsibility to reassess the delegation of authority to the Federal Reserve. But I do not find very much in the way of sympathy with the idea of politicizing the Federal Reserve. And to superimpose a congressional or other judgment during very difficult periods of the economic cycle, you know, that do produce high interest rates, for example—to substitute our judgment with that of the administration for that of the Federal Reserve.

Mr. STAATS. Well, that is obviously a judgment that you have to make here. But the idea would be, as to whether or not information could not be developed which would enable Congress to make this judgment more advantageously than it is today.

Mr. ASHLEY. Thank you, sir.

The CHAIRMAN. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman.

Mr. Staats, I have many questions, so I hope that you will make your answers as brief as possible and then expand upon them in the record, if you would.

First of all, the Government Corporation Control Act of 1945 which exempted the Federal Reserve System from audit was reported by the Government Operations Committee. I am a member of that committee, and I wonder if you have talked with that committee with respect to the removal of the exemption?

Mr. STAATS. I have not. No.

Mr. BROWN. Would that not possibly be the most direct way to accomplish that which you are proposing? Shouldn't you just advocate the removal of the exemption?

Mr. STAATS. It would be one way to do it. It had not occurred to me.

Mr. BROWN. Let me be a devil's advocate for a minute, Mr. Staats. The chairman in his statement indicated that the expenses of the Federal Reserve System have increased 210 percent from 1964 to 1972.

What was the budget of the General Accounting Office in 1964?

Mr. STAATS. 1964? I would have to check this, but it would be—

Mr. BROWN. Well, supply this for the record. I would like to know whether your budget has increased 210 percent between 1964 and 1972.

Mr. STAATS. No, it has not increased that much, but it has increased substantially.

In response to the request of Mr. Brown, the following information was submitted for the record by Mr. Staats:

The obligations incurred to finance the activities of the General Accounting Office amounted to about \$44 million in fiscal year 1964 and about \$88 million in fiscal year 1972—an increase of 100 percent.

Mr. BROWN. Has the General Accounting Office purchased any ping pong balls for its employees?

Mr. STAATS. I do not think so.

Mr. BROWN. Or music? Do you provide any of the recreational aids for your employees similar to those the chairman has cited in his statement?

Mr. STAATS. No, sir.

Mr. BROWN. You have suggested that every governmental entity should be audited. I have two questions. First, who audits the GAO?

Mr. STAATS. Well, you fellows do a pretty good job of it here. We are part of the legislative branch, as you know. We have an internal auditor, and we get a good review each year by the Appropriations Committee. But being a part of the legislative branch, I think we are in the same kind of a position that you are here.

Mr. BROWN. That prompts my next question; who audits the Congress?

Mr. STAATS. Well, we do, some of it. By law, we are required to do some of it.

Mr. BROWN. With respect to internal and independent audits, do you have any question about the integrity or the adequacy of these audits especially those done for agencies by outside auditors? I thought you indicated that you did.

Mr. STAATS. No. I hoped I made my point very clear here. We have no evidence to date to question the integrity of any of the external audits made for the Board. From what information we do have, we do have some question, quite honestly, as to the adequacy of the audit, of at least the kind of audit that we would regard as deemed best.

Mr. BROWN. Mr. Staats, at your suggestion, the chairman put into the record a one-paragraph report from the outside auditor of the Federal Reserve Board. That was not the total audit report, was it?

Mr. STAATS. That is all that has been made available to the Congress.

Mr. BROWN. Well, does not the Federal Reserve Board provide an annual report in which is indicated the transactions of the Board and its activities?

Mr. STAATS. I could be wrong on this, but it is my understanding that in this case not. Some accounting firms do provide more elaborate reports, but in this case, to the best of my knowledge, not.

Mr. BROWN. In the course of your answering of questions for Mr. Ashley, I think you said that this committee has the responsibility to see that the system is functioning properly. Could not the objective that is intended by this bill, as far as the audit provisions are concerned be accomplished by this committee calling in on a regular basis the officers, witnesses of the Federal Reserve and going over its annual report, in effect, doing the very thing you are suggesting?

Mr. STAATS. With respect to the third type of audit which I referred to, I would not say that this could not be done. That would be whatever the committee felt in its judgment was necessary.

I do have some doubts whether on the first two types that you are getting, or could get, the kind of independent judgment which would be needed.

Mr. BROWN. Now, along the same line, Mr. Staats, I remember your appearing before this committee sometime ago in connection with uniform cost accounting practices legislation.

Could not the audit objective contemplated by the passage of this bill be accomplished by your establishment of guidelines, data requirements, and informational minimums for all independent audits performed on the Board's operations, with the GAO acting only in an audit oversight function?

Mr. STAATS. That would be one possibility.

Mr. BROWN. And it would not involve the duplication of work, would it? You have said that you are going to be reviewing the data supplied by independent audits any way, right?

Mr. STAATS. It would be one step short of No. 1.

Now, let me just add, if I could, one point here with respect to the Inter-American Bank. The Congress did specify that we would prepare advisory standards for the Treasury and the Inter-American Bank Board of Directors, and that system has been in operation for about 3 or 4 years. And there is pending in the Congress now legislation in the Foreign Aid Act which would extend that to other international organizations. So you do have some precedent for the suggestions you are making.

Mr. BROWN. Now, is it a good decisionmaking practice of which your agency would approve to authorize and order a course of action when no estimate of its cost can be made?

Let me explain, again, being the devil's advocate; Is that not what you are recommending for this committee to do and the Congress to do? You say you can determine and estimate the cost of the first two types of audits, but you have no estimate of the cost of the third?

Mr. STAATS. Not until you get into it and get information on that. That is true with any agency. With respect to the first two audits, we think we know enough about how to do this that is pretty clear.

Mr. BROWN. But would you not be critical of an agency that made a decision without being able to estimate the cost of the action?

Mr. STAATS. We could not do more than what we have in our budget. It would have to take its place among the priorities in our budget. And, of course, we would respond to the request of the committee if the committee wanted us to look into some particular problem.

Mr. BROWN. Let me ask you another question that falls outside the jurisdiction of this committee. Has any investigation, audit, or anything of this nature been performed on the data processing system that we presently have operating in the House and has there been a critique of the effectiveness of the expenditures?

Mr. STAATS. Well, we are doing, as you know, a great deal of work with the Congress in this area now, attempting to provide the systems for better fiscal and program data for all the committees of Congress. This grows out of the Legislative Reorganization Act of 1970.

The CHAIRMAN. The time of the gentleman has expired.

Mr. Moorhead?

Mr. MOORHEAD. Thank you, Mr. Chairman.

Thank both of you for your excellent statements.

Mr. Staats, I have no trouble with your first and second alternatives, but it is the third alternative that I would like to discuss with you, particularly when we think about the operations of the Open Market Committee.

You would review the results and programs and activities of the open market system, including the extent to which its established objectives were being achieved. I am torn between two dilemmas here.

One, we established this system to remove, certainly, the political pressures from the monetary decisions. So my first concern is, will the fact that you are going to be looking over the shoulder of these people make them more timorous and afraid to take decisive action?

The second one is that the Constitution does give the Congress the power and the duty to coin the money and regulate the value thereof. We delegated that almost entirely to the Federal Reserve System, which has, to a large measure, redesignated that to the Open Market Committee. I think that without some supervision by our expert, the General Accounting Office, we cannot continue our constitutional duty of oversight of the body that we created to do our job.

Can you help me out of that dilemma?

Mr. STAATS. It is a dilemma, Congressman Moorhead, and I want to make one point very clear. I think from the questioning here this morning it might appear that we are advocating the third alternative. We believe the bill as presently drawn contemplates all three, although we think it can be improved with respect to the clarity of the drafting.

What we have said this morning is that we favor an audit of the Board. Congress has to make the judgment as to which of these three types.

Mr. MOORHEAD. I quite agree. But I am asking you for help and guidance in making my judgment.

Mr. STAATS. I am afraid, from the questioning and the discussion we have had here this morning, that the impression may be that we are urging the Congress to adopt all three, and we are not. We are saying there should be an audit. I think the committee and the Congress have to make the judgment as to how far that audit should go.

You can make the better judgment than we as to how you conceive your relationship in the Congress to the delegation which has been given to the Board. But what we have tried to do is frame three options, because all three options are in the language of the bill as we see it today.

Mr. MOORHEAD. When you said that in other legislation, safeguards had been written in, I think maybe we should be thinking about safeguards in this. And I am taking the typical example of the alternative 3, the Open Market Committee. I do not think you should be auditing them on the day-to-day decisions; that is too quick. But maybe a year later, an audit would be proper, and the decisionmakers would not feel your hot breath on their backs.

Mr. STAATS. And they should be included, even if you are only going to do No. 1. That is why we have made some references to it. Even if you are only going to do No. 1, they should be included, because they are part of the system.

Mr. MOORHEAD. I have no problem there. But it is only when you get down to No. 3, are they going to be second-guessed in such a way that it will inhibit correct decisionmaking by you?

Mr. STAATS. This is a dilemma, Congressman Moorhead. We are doing the third type of audit very extensively in the Government now. About one-third of the work that we do overall is in the nature of looking at the effectiveness of ongoing programs, welfare, agriculture, water resources, and so forth. The degree of sensitivity involved differs in each case, and this is the dilemma that you refer to. I think this is a problem that the committee has to address itself to.

Mr. MOORHEAD. I think there is a difference. We have talked a lot about the independence of the Federal Reserve System. Of course, it is an independent subject to Congress. But we have concluded at least thus far, that we get better decisions if we maximize independence. The ultimate question is, will we get worse decisions from the Open Market Committee with you looking over their shoulder? That is the question I have.

Mr. STAATS. Well, we would not be looking over their shoulder in advance of any judgment made, in any event.

Mr. MOORHEAD. But a day or two afterward would almost be the same.

Mr. STAATS. No; we would be interested in the longer term operation and the process by which they perform their responsibilities.

Mr. MOORHEAD. Thank you very much.

The CHAIRMAN. All right, Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman, and Mr. Carlock and Mr. Staats. I want to thank you for being here this morning. Mr. Carlock, I trust that you recognize the fact that you have testified on the noncontroversial parts of this bill, and that is why you are not getting any questions.

We appreciate having you here.

Mr. Staats, how many people are employed by the GAO?

Mr. STAATS. I think the number of professional employees is, the best indication for your purposes, we have 3,300 professional employees. We have a total staff of about 4,800, but about 3,300 of these are professionals.

Mr. WILLIAMS. Fine.

Now in many of your answers to questions you used the word "we." On page 5, in the second paragraph, you say "we have concluded that there should be a GAO audit of the Federal Reserve Board and the Federal Reserve banks."

Who do you mean when you say "we?"

Mr. STAATS. The General Accounting Office. That means myself. We use the word "we" when we were referring to the position of the office. This is not a decision—this judgment was not made lightly. It involved consultation with my senior staff.

Mr. WILLIAMS. I think your alternative is probably correct. You keep saying that 1 and 2 are virtually the same alternatives. Actually this is not true. In addition to alternate 1, alternate 2 says such things as:

Examination of the management of resources to evaluate the efficiency and economy with which resources are procured and used, such audit work would include determining the causes of any inefficient or uneconomical practices found and proposing constructive recommendations for improvement for the consideration of management officials.

And then you go on to say that under this bill alternative 2 would even include recommendations for attaining a more economical and efficient administration of the entities audited.

In other words, to me it appears that all you would be doing would be substituting your judgment against the judgment of the Board of Governors of the Federal Reserve.

Isn't that correct?

Mr. STAATS. Yes, but we can point to dozens if not hundreds of illustrations where we have made recommendations for improvements which save money in other agencies.

Mr. WILLIAMS. That is quite correct for other agencies, but this is entirely financial people.

Mr. STAATS. Last year about \$300 million of savings were made which could be directly attributable to our recommendations which the agencies accepted before we even finished our report.

Mr. WILLIAMS. Let me repeat my statement. These other agencies you are talking about are not agencies that consist entirely of financial people. Now, let me go on to the next question about the amount of business that the Fed has, a \$738 billion turnover in 1970.

What percentage of that was due to deficit Federal spending as well as paying off maturing Federal obligations with a low interest rate, and paying them off by borrowing money at a much higher interest rate?

Mr. STAATS. I cannot tell you. This is the total transactions figure that I have. I might be able to get that for you for the record.

Mr. WILLIAMS. Please do, and I am certain that you will find that it is a very substantial portion of the \$738 billion.

[In response to the request of Mr. Williams, the following information was submitted for the record by Mr. Staats:]

The \$738 billion figure referred to was included in our report dated October 6, 1971, to the Vice Chairman of the Joint Economic Committee on the Federal Reserve Reporting System for Recognized Dealers in Government Securities. In 1970 the 20 recognized dealers in Government Securities purchased and sold \$738 billion in Government securities—this figure included all transactions not

just those with the Federal Open Market Committee. The Annual Report of the Board of Governors for 1970 shows that the value of the Federal Open Market Committee transactions for that year was \$110 billion. We have no information on the effect of deficit Federal spending or the redemption of maturing Federal obligations on the transactions of either the recognized dealers or the Open Market Committee.

Mr. WILLIAMS. Incidentally, you did mention a bill, from July 20, 1959, H.R. 8302, which called, in effect, for the GAO to audit the Federal Reserve Board and the Federal banks for a period of 45 years.

Who introduced that bill, and were hearings ever held on it?

While you are getting the information to respond to that question, let me add one other point.

You say that the GAO does an internal audit. That is precisely what the Federal Reserve Board is doing.

Mr. STAATS. No, sir, you misunderstood me. We do not do internal audits. We make an external audit as an independent agency of the Congress of the agencies' own program.

Mr. WILLIAMS. Well, that is precisely what the Federal Reserve Board has, an internal audit as well as employing outside auditors.

Mr. STAATS. That is true of every agency of the Government. They all have internal audits, and we are for strengthening those audits. We think that is a good thing to do.

And many of our reports that we make are designed to suggest ways they can strengthen them.

Mr. WILLIAMS. You are suggesting that the Federal Reserve go further than your own department is going.

Do you have the answer to my previous question yet?

My question was, who introduced this bill and were public hearings ever held on it?

Mr. STAATS. The bill was H.R. 8302. It was introduced by Chairman Patman, and to the best of my knowledge, our file here does not show any—whether hearings were held or not.

The CHAIRMAN. What is the date of that bill?

Mr. STAATS. July 20, 1959.

Mr. WILLIAMS. Mr. Chairman, do you understand, and Mr. Staats, that this bill pending before us does require an annual audit of the Federal Reserve Board, and the other entities by your department?

Mr. STAATS. That is the wording in the present bill. We have suggested that that annual requirement be changed.

Mr. WILLIAMS. Thank you.

The CHAIRMAN. I wonder if we should recess for noon or should we proceed?

Mr. STEPHENS. Mr. Chairman, I have no questions that I wish to ask. I want to thank the witnesses for the testimony they have given.

The CHAIRMAN. Without objection, we will recess until 2 o'clock this afternoon, if that will be satisfactory with Mr. Staats and Mr. Carlock.

[Whereupon, at 11:50 a.m., the committee was recessed, to reconvene at 2 p.m., the same day.]

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

Now, the second member is Mr. Stephens. Mr. Stephens said he did not want to ask any questions, and so the next one is Mr. Wylie. Mr. Wylie is not here.

Next is Mr. St Germain. He is not here. Next is Mrs. Heckler. She is not here. Mr. Gonzales is not here, and Mr. Crane is not here. Mr. Minish is not here. Mr. Rousselot is not here. Mr. Hanna is not here. Mr. McKinney is not here. Mr. Gettys is not here. Mr. Frenzel is not here.

Mr. Annunzio is here.

Mr. Annunzio, do you want to ask any questions?

Mr. ANNUNZIO. Thank you, Mr. Chairman.

I want to join my colleagues in commending Mr. Staats for his very constructive statement, and I for one want you to know that I take the position that you are not on the spot here. Some of the questions have been directed to you as though you were the proponent of this legislation. And I would like the record to be clear on that point, that you merely expressed your opinion that this legislation was written and formulated by the Banking and Currency Committee; and that as a witness, we are indeed grateful for your expertise.

I have a few short questions that I would like to have answered.

When Dr. Burns was here, one of the questions to Dr. Burns was: Why do you object to an audit of the Federal Reserve System? And he said, oh, we have all kinds of audits, and I don't object to an audit of the Federal Reserve. We have no secrets, he said, but I do object to the Comptroller General doing the audit because they would do more than audit. They would set policy.

What is your reaction to the statement of Dr. Burns?

Mr. STAATS. Well, we do not set policy, and in fact, we avoid making policy recommendations except insofar as they may relate to our own jurisdiction, our own responsibility.

Now, we do attempt in other cases to review whether the programs in our opinion are carrying out the intent of the Congress in legislation; but we do not recommend policy of the type that the chairman referred to, and we would not intend to do so even if this legislation were enacted, because we do not think this legislation calls upon us to do that.

Mr. ANNUNZIO. General, one other question. In reading these reports I find, for example, that the Federal Reserve Board pays for memberships in all types of professional organizations. I cannot refer specifically to the page, but they had a meeting in New York; the luncheon cost them \$18,000; the cost of the printing was \$50; the payment for the preacher was \$15. They have their members, they pay dues for belonging to bar associations. They go on and pay all sorts of moving expenses for their employees who move across the country. And some of those expenses are really astronomical.

What I am trying to find out from you, as the Comptroller General of the United States, because you do do a tremendous job in auditing the Department of Commerce, the Transportation, and the Defense Department, is whether this practice is prevalent in these other departments in government?

Mr. STAATS. The type of expenditures that you refer to, specifically memberships in organizations, the holding of luncheons, and the paying for the cost of that type of expenditure are generally not available to other departments and agencies.

Now, the only exception relates to entertainment where those are specifically provided for in the appropriation act, and principally they are in connection with the State and Defense Department and other agencies which have responsibility for official entertainment of foreign visitors.

Now, with respect to membership in professional organizations and other organizations, the law does not permit this for other agencies. It is possible for an agency to pay for the registration fee for an individual going to a conference if they regard it as being important for training purposes; but they do not pay his membership fee in that organization.

Mr. ANNUNZIO. It is a very important point you made, that it goes through the appropriation processes. What the Federal Reserve Board is doing, it is doing on its own.

And there is one other point I want to make that everybody is losing sight of. In this day and age, we talk about full disclosure, we talk about no secret meetings, we open up the doors and we are not having any more executive sessions under closed doors, we let the reporters in, let the TV people in, and let the public in when we mark up a bill in executive session. Throughout the entire country, whether you are a city councilman, an assemblyman, or a Congressman, full disclosure is expected of your personal holdings, and we are keeping no secrets from the public.

Why is the Federal Reserve Board so opposed to public policy? This is public policy, full disclosure today; to have full disclosure and to have a competent agency such as yours come in to make an audit.

I would like your comments on how you feel about full public disclosure of all agencies. We can carry this business of independence too far.

The CHAIRMAN. Let Mr. Staats answer this.

Mr. STAATS. I would say in answer to your question that one of the functions of our office is not only to audit and to develop recommendations for improvement in management effectiveness of those agencies, but to provide information to the Congress upon which it can exercise its legislative oversight functions.

Mr. ANNUNZIO. This is information that the Congress needs badly.

Mr. STAATS. We have been testifying, along with many others, before the Select Committee on Committees which Congressman Bolling is chairing, and if I read their views correctly, based on our testimony, they feel that if anything we are not providing enough information to the Congress by way of information which they can use to exercise oversight responsibilities.

Congressman Barrett questioned this morning as to why I have taken the position that I favor some kind of audit of the Federal Reserve Board. This was one of the reasons that I was responding to you, Congressman Barrett, along the lines that I did—the importance of disclosure and having better information.

Mr. ANNUNZIO. Thank you for your very excellent testimony.

The CHAIRMAN. Mr. WYLIE.

Mr. WYLIE. I will pass, Mr. Chairman.

The CHAIRMAN. Mr. Hanley.

Mr. HANLEY. Thank you very much, Mr. Chairman.

Mr. Staats, I commend you for your testimony. I do have one area of concern, as one who has long been interested in the matter of Federal employee benefits, and one who bears a direct responsibility in this matter.

It has been called to my attention that employees of the Federal Reserve did not contribute to the retirement program. Is that right?

There is no contribution on the part of employees in the Federal Reserve to the retirement program?

Mr. STAATS. If I understand correctly—and I would like to check the record on this, Congressman Hanley, for sure—they have a system which has been set up for employees who have worked only in the Federal Reserve System. They have another fund which is for individuals who transferred in, who have been under the civil service retirement fund or some other Federal retirement fund, in which case those are continued so as to not change its benefit structure.

But as to whether or not their own fund is contributory or not, I will have to check that.

Mr. HANLEY. Well, the information I have is that they do not contribute anything, yet enjoy the advantages identical to all others in the Federal fraternity.

So if you would provide us with that information; and if that is the case, it is purely discriminatory, as much as we expect from all other Federal employees a contribution in the amount of 7 percent of the gross salary.

So it would be quite unfair if those serving one entity of Government enjoyed the accommodation that has been referred to by me.

Mr. STAATS. This is the kind of a matter that we would look at in what I described this morning as the second type of audit. The management and economy and efficiency structure of benefits for employees, the travel benefits, all of these kinds of things would be covered in the second type of audit which I described as a management type or economy-efficiency-type audit.

Mr. HANLEY. Fine. Well, if you will be good enough to provide the committee with the answer to my question, yes or no, whether or not they do contribute to the pension fund. And if the answer is in the negative, then we would appreciate its rationale.

Mr. STAATS. We will do that.

[In response to the request of Mr. Hanley, the following information was submitted for the record by Mr. Staats:]

We were advised by an official of the Federal Reserve Board that Federal Reserve employees are covered by three different retirement plans, two of which are contributory and one is not.

1. *Civil Service Retirement Plan.*—Employees of the Board who come directly to the Board from covered Federal Government employment continue in this system. The employees' contribution, currently 7 percent, is deducted from their salary matched by a similar payment by the Board and paid to the U.S. Treasury for deposit in the Civil Service Retirement Fund.

2. *Federal Reserve Board Plan.*—Board employees not covered by the Civil Service Retirement Plan are covered by the Board Plan. The employees' contribution to this plan is the same as under the Civil Service Retirement Plan. The contributions of the Board are actuarially determined each year. The benefits are similar to those of the Civil Service Plan.

3. *Reserve Bank Plan.*—Employees of the Federal Reserve Banks and branches are covered by this plan. Prior to January 1, 1970, this was a contributory plan and deductions were made from employees' salaries. Since January 1, 1970, this has been a non-contributory plan—the employees contribute nothing and all costs all costs are borne by the banks.

The employees of the banks are covered by Social Security while the employees of the Board are not. We were advised that the benefits of the Reserve Bank Plan are not as good as those provided by the plans applicable to Board employees and are intended to supplement Social Security benefits.

The CHAIRMAN. Mr. McKinney.

Mr. MCKINNEY. No questions, Mr. Chairman.

The CHAIRMAN. Next is Mr. Cotter.

Mr. Cotter.

Mr. COTTER. Thank you, Mr. Chairman.

Welcome, Mr. Staats, and I want to commend you and the General Accounting Office for the fine work you have been doing. I have just a couple of brief questions.

How often are Federal agencies audited? Is it on a regular basis?

Mr. STAATS. Government corporations by law are to be audited once a year. That is a financial audit or a commercial-type fiscal audit as we describe it.

With respect to other agencies, we go into them either as requested by the Congress or by one of its committees, or where we on our own believe that a matter needs to be looked at because of the size, the amount of money that is involved, the indications of problems, or where we know an authorization is going to expire and Congress would be interested next year, matters of that type.

We very seldom will make a complete audit embracing all three types of audits of a complete agency. We would not have the manpower, and we do not think it would be needed. And besides, that is one of the functions of that internal auditor there, is to be on top of these matters. And we rely to a considerable extent upon him, if he is doing a good job.

Mr. COTTER. Well, very frankly, I am relatively new here, and I was always under the impression that the Federal Reserve was audited. Until the introduction of this bill, I had just assumed that they had been.

There were some questions raised by Dr. Burns in some very sensitive areas which could jeopardize the whole system as a result of an audit. You must run into situations like this at the Defense Department, the CIA, and other agencies.

Cannot this be handled by an agreement between the agency, or a discussion, or some type of legislation to protect these areas?

Mr. STAATS. Yes; we have these problems in many areas, and we have to exercise some judgment. And if there is need for confidentiality of information in a report that we make, we can do that separately in a classified document.

For example, many of the reports we deal with involve proprietary information of a company which, if made available publicly, would damage him in his competitive relationship in the industry in which he is involved. So we have that kind of a situation.

We have another kind of a situation where there may be a claim against the Government, where the claimant and the Government are negotiating out the amount of the claim. We have to keep that kind of information out of the public arena.

Security-type information—the Defense Department, the State Department—we have had a lot of experience dealing with this kind of problem; and I think we have been reasonably successful.

Mr. COTTER. You, as I recall, raised some objections to an annual audit. Is that correct?

What you would like is flexibility to go in there wherever necessary?

Mr. STAATS. We do not think it would be necessary to do it on an annual basis.

Mr. COTTER. Supposing that the bill were drafted in such form that it must be done at least once during a 5-year period. Would that make more sense?

Mr. STAATS. Or even a 3-year period. We have recommended to Congress with respect to Government corporations that we be allowed to exercise discretion so as to make it possible to audit within a 3-year period; and that would be satisfactory here I am sure.

Mr. COTTER. I know insurance companies are audited on a 5-year basis. This is why I raised that, because it is a large job and an expensive one.

Thank you very much.

The CHAIRMAN. All right.

Mr. Burgener.

Mr. BURGNER. Thank you very much, Mr. Chairman.

I missed the last portion just before lunch, so, Mr. Staats, if I am repetitive, I apologize.

You suggest three alternatives as possible ways to go on an audit. Well, the first two, I would agree, or most of us, would be relatively noncontroversial. The third gets into sort of a gray area, so my question is this. In the third area would you be judging policy?

I will give you an example. On July 5 the Federal Reserve took an action that some people applauded and others thought was disastrous. You know, approval of the wild card certificate relating to banks.

It resulted in the transfer of an immense amount of money around to the financial institutions. Would your third alternative pass judgment on such an action if you happened to be auditing at that particular period of time?

Mr. STAATS. It would not preclude it. I will put it that way. The third alternative could include that type of analysis, again after the fact. And as I indicated this morning, we would be probably more concerned with the process by which a decision was reached, rather than whether or not it was a good decision or a bad decision.

But it certainly would not rule out dealing with that type of action. I would not want to mislead you.

Mr. BURGNER. Well, that is very clear, and I appreciate it.

A second question. You are in support of H.R. 10265, I take it, although you recommend some changes in drafting and so on? Is that correct?

Mr. STAATS. I want to be very precise about how I say this, because I think we had some, maybe not misunderstanding but lack of clarity on this point this morning.

I was faced with three alternatives. I could have said we are opposed to the legislation. I could have said we are neutral about it, or that we favor an audit. I concluded that our position should be that we should support the idea of an audit of the Federal Reserve System.

I outlined three alternative ways in which legislation could be written. The legislation as drafted today, at this point in time, includes all three. I have attempted to formulate language which would be more precise and improve the language; but the language that we have suggested is no broader, as we interpret the language that is before the committee today.

Is that clear?

Mr. BURGNER. Yes, indeed. Very good.

Finally, Mr. Chairman, if I may, does this represent a change in position—I am new here—versus last year or previous years on your part?

Mr. STAATS. This is the first time I have testified on this subject since I have been Comptroller General.

Mr. BURGNER. I should know, but when were you appointed?

Mr. STAATS. 1966.

Mr. BURGNER. 1966.

Mr. STAATS. The General Accounting Office prior to my appointment had taken a neutral position on the matter.

Mr. BURGNER. In brief, what factors motivated you principally to change your position from neutral to supportive?

Mr. STAATS. Well, I have not changed my position.

Mr. BURGNER. I see. This is your first time in actually advancing it in this form.

Well, I thank you, Mr. Chairman and Mr. Staats, for very illuminating testimony.

The CHAIRMAN. Mrs. Boggs.

Mrs. BOGGS. Thank you, Mr. Chairman.

I would like some language clarified, please, if you would. On page 7 of your statement when you say that "We have assumed that this language would give the GAO access to examination reports of member banks in the custody of the Board or the Reserve banks prepared by bank examiners of the Comptroller of the Currency, the FDIC, and the various States," does that mean that you already have jurisdiction over the examination of the bank examiners of these institutions?

Mr. STAATS. No.

Mrs. BOGGS. You do not?

Mr. STAATS. No.

Mrs. BOGGS. So that this would not mean that this audit would simply add the Federal Reserve banks?

Mr. STAATS. This suggests that we make it clear that those ought to be included irrespective of what type of audit the Congress should decide on.

Mrs. BOGGS. Thank you very much.

Mr. WYLIE. Would the gentlewoman yield on that point?

Mrs. BOGGS. Yes.

Mr. WYLIE. Would you support an amendment, Mr. Staats, that would remove such assumption and make it unmistakably clear that the GAO audit would not include member banks?

Mr. STAATS. It does not include the member banks.

Mr. WYLIE. But in your paper you say we have assumed that this would be in the bill and H.R. 10265 would include it and give you access to the reports of member banks.

Now, I think the confidentiality of our reporting system has to be part of the whole banking system, and my question is, do you think that we should add an amendment that would remove such assumptions so that the member banks would be examined by the comptroller or the FDIC as they are at the present time?

Mr. STAATS. Are you referring to the last paragraph on page 7?

Mrs. BOGGS. Yes.

Mr. STAATS. What we are doing here is simply stating our interpretation.

Mr. WYLIE. My question is, would you support an amendment that would place a different interpretation or make it unmistakably clear that the GAO would not conduct an audit for reports of member banks?

Mr. STAATS. I think to review the adequacy of the bank examination we would probably need access to that type of information from time to time, but we would not propose to audit the member banks, not at all.

Mr. WYLIE. So an amendment which would suggest that this assumption that you have access to the member banks would not bother you. It wouldn't do violence to the general purpose of this bill, which is to audit the Federal Reserve Board.

Mr. STAATS. It is just examination of reports that we are concerned with and not audits of the banks themselves, examination of reports based on the Federal Reserve's audit of those banks.

Mr. WYLIE. Well, that's what I am concerned with, too. Is it essential that you have access to reports of member banks in order to make an audit of the Federal Reserve?

Mr. STAATS. Well, you can draw this line several different places here, but our view, I think, would be that if we are going to make a judgment on adequacy of the bank's supervisory functions that the Federal Reserve Board exercises, we would need to have access to the reports that they prepare in making those bank examinations. That's all we are trying to suggest here. I do not quite see how we can make a good judgment—

Mr. WYLIE. Well, has not the member bank audit been the real hangup or source of most of the difficulty for the past 20 years on this question of the Federal Reserve audit by GAO?

Mr. STAATS [continuing]. No, sir. That may be part of it, but I do not think that is the basic point.

Mr. WYLIE. What is the basic point?

Mr. STAATS. I think the basic point is they are concerned with respect to, frankly, the third type of audit that we have described in our presentation. That is my understanding. I do not propose to speak for the Board. They can speak for themselves very well, but that is my understanding.

Mr. WYLIE. I wonder, Mr. Chairman, would it be appropriate to call the Comptroller of the Currency and the Chairman of the FDIC on this point?

The CHAIRMAN. Not today.

Mr. WYLIE. Not today, of course.

The CHAIRMAN. Of course we could do that.

Mrs. BOGGS. My time is up, Mr. Chairman.

The CHAIRMAN. Let's consider it.

[Discussion off the record.]

The CHAIRMAN. Without objection, we will recess until tomorrow morning at 10 a.m.

Will that be imposing upon you gentlemen too much?

Mr. STAATS. We are at your disposal.

The CHAIRMAN. We will stand in recess until 10 a.m. tomorrow morning.

[Whereupon, at 2:30 p.m. the committee was recessed to reconvene at 10 a.m. Wednesday, October 3, 1973.]

TO PROVIDE FOR AN AUDIT OF THE FEDERAL RESERVE SYSTEM BY THE GENERAL ACCOUNTING OFFICE

WEDNESDAY, OCTOBER 3, 1973

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman [chairman] presiding.

Present: Representatives Patman, Barrett, Reuss, Ashley, Moorhead, Cotter, Boggs, Widnall, Johnson, Stanton, Blackburn, Brown, Williams, Heckler, Rousselot, and Roncallo.

The CHAIRMAN. The meeting will please come to order.

This morning the committee meets to continue hearings on H.R. 10265. Yesterday we heard from a representative of the Treasury Department concerning the Federal Reserve draw section of the legislation and also from Comptroller General Elmer B. Staats, concerning the GAO audit of the Federal Reserve System provisions of the bill.

General Staats testified yesterday that the expenditures of the Federal Reserve System are no different from taxpayers' funds and, thus, there is no reason why the Federal Reserve System should not be audited by the GAO.

He also said that the GAO, as opposed to previous years when it simply said it would conduct an audit of the Federal Reserve System if so mandated by the Congress, is now calling directly for such an audit. This is indeed an important statement for the head of the General Accounting Office, the so called **congressional** watchdog agency and one which should be given great **weight** by members of the committee.

General Staats also said that he did not feel that the operations of the Federal Reserve System would in any way be adversely affected as a result of an audit.

Based on this, unless the Federal Reserve Board today can make a strong case to show this committee how its operations would be hampered by an audit, I see no reason why this committee should not vote to extend a GAO audit to the Federal Reserve System.

In preparation for these hearings I have had the staff of the Banking and Currency Committee review the expenditures of the Federal Reserve System for the calendar year 1972.

The staff has prepared a report which outlines a number of areas in which the Federal Reserve System is spending taxpayers' money in what I believe is a highly questionable manner.

Every member of the committee has been furnished a copy of that report and I am asking at this point that the report be made a part of the hearing record.

There being no objection, this report will be made a part of the hearing record.

[The report referred to by Chairman Patman follows:]

FEDERAL RESERVE EXPENDITURES OF TAXPAYERS' FUNDS—ONLY A GAO AUDIT
WILL SOLVE THE PROBLEM

SUMMARY

Despite assurances from the Federal Reserve Board Chairman Arthur Burns that there would be a careful review of all expenditures within the Federal Reserve System to make certain that unnecessary expenditures were eliminated, there appears to have been no appreciable change in the System's method of spending the taxpayers' funds.

It is imperative that the System be held accountable for its method of expending funds, particularly in light of the tremendous increase in the budget of the twelve Federal Reserve banks and their branches. For instance in 1964 when the Domestic Finance Subcommittee conducted a thorough review of the Federal Reserve expenditures, the total expenses for the year was slightly more than \$197 million. However, in 1972 the total expenditures for the year had increased to more than \$414 million, an increase of 210 percent over the 1964 level.

Banking Organizations Continue to Receive Fed Money

In two particular areas the Federal Reserve Banks continued to spend funds in a highly questionable manner. These involved contributions and dues to various agencies, including a large number of banking organizations and the expenditure of funds of the transfer of employees from one bank to another or the movement of a new employee from one city to another. It appears that these payments are made for virtually every expense that the employee incurs regardless of its relationship to his job. For instance, Mr. J. J. Balle was given more than \$19,000 in connection with his move from Pittsburgh, Pennsylvania, to San Francisco, California. There was virtually no documentation for these expenditures.

In the area of dues and contributions the staff has noted that while there may be some changes in the payment to various organizations, the figure is still abnormally high and some contributions are being made in a highly questionable manner. Although Dr. Burns has told the Domestic Finance Subcommittee that dues would no longer be paid to the American Bankers' Association and related state banking agencies, banking organizations either directly or indirectly related to the American Bankers' Association still receive large membership dues from the Federal Reserve banks and their branches. In 1972 three banking organizations, Bank Administration Institute, American Institute of Banking, and Robert Morris Associates, received more than \$80,000 in dues from the Federal Reserve banks and branches. In addition, several state banking associations were beneficiaries of the Federal Reserve Banks' generosity, although in some cases these payments were virtually disguised. The chief payment in this category was an \$8,000 expense of a New York Federal Reserve Bank for a luncheon for the New York and New Jersey Bankers' Associations.

Fed Payments Go to Large Number of Unnecessary Groups

The staff also found that the Federal Reserve Banks and branches held memberships in more than 260 organizations including state and local Chambers of Commerce, bar associations, restaurant associations, nurses associations, and a large variety of such groups that have virtually no compatibility with the function of the Federal Reserve Banks.

The Federal Reserve Banks and branches also spent quite heavily in the area of social, athletic and recreational activities.

A payment of more than \$85,000 was made to various Federal Reserve clubs operating throughout the System. These clubs are social and recreational organizations for bank employees. The Federal Reserve System has refused to allow the staff of the Banking Committee to review the expenditures of these clubs contending that once the banks turned the money over to the clubs that it is theirs to spend as they desire.

In addition to the money spent in the Federal Reserve Club, most banks provide funds for a large variety of other athletic activities. For instance the Federal Reserve Bank of Dallas bought 1,152 ping pong balls during 1972 at a cost of \$155.74. Since the Dallas Federal Reserve Bank has only 895 employees it means that theoretically there was more than one ping pong ball purchased for every employee of the bank. Other banks spent large sums of money for purposes such as art club instructors, bingo parties, and a choral director and accompanist that cost the Richmond Bank more than \$1,400.

The method in which the Federal Reserve Bank spends taxpayers' money clearly indicates that it is necessary that the banks be audited by the General Accounting Office. Dr. Burns feels that the only test that should be placed on the Federal Reserve expenditures is whether or not the banks are getting value for their money. This logic is totally unanswered in the question of whether or not such expenses are necessary and only an audit will determine whether or not the taxpayers are being protected against abuses such as those uncovered by the staff study.

INTRODUCTION

In 1964 the Domestic Finance Subcommittee of the House Banking and Currency Committee conducted an extensive review of the operations of the Federal Reserve System. The twelve Federal Reserve banks and their branches had total expenditures for the year of \$197,395,889.

Those funds were expended without any outside review including an audit of the General Accounting Office.

The Domestic Finance Subcommittee in 1964 questioned thousands of dollars of expenses of the banks and their branches as being unrelated to the function of the Federal Reserve System.

At that time Chairman Patman introduced legislation that among other things would have required an annual audit of the entire Federal Reserve System by the General Accounting Office. Such an audit would have precluded the waste of taxpayers' money¹ that was uncovered in the 1964 study by the Subcommittee.

No change in spending pattern

Since 1964 the staff of the Banking Committee has periodically reviewed the expenditures of the Federal Reserve banks and their branches, and while there have been some curtailment of certain expenditures, for the most part, the twelve banks and their branches continue to spend money in a virtually unrestrained, unsupervised and unaudited manner.

In 1972 the Federal Reserve Banks and their branches had increased their total expenses to \$414,608,417. This represents a 210 percent increase over the 1964 expenditures. (See Table I) Included in these increases is a 201 percent increase in the salaries of officers, a 185 percent increase in the salaries of employees, and an increase of 612 percent in fees paid to directors and others. Although these expenses have increased at an alarming rate, there still remains no outside audit of how the Federal Reserve System spends its funds.

TABLE I.—EXPENSE TOTALS OF THE FEDERAL RESERVE BANKS AND BRANCHES

Year:	Total expenses	Salaries		Fees, directors, and others
		Officers	Employees	
1964.....	\$197,395,889	\$7,741,458	\$100,462,115	\$537,418
1965.....	204,290,188	8,052,238	99,963,787	632,265
1966.....	207,434,049	8,536,990	103,121,306	653,959
1967.....	220,120,843	9,123,383	110,081,297	973,730
1968.....	242,350,223	9,970,371	119,111,047	1,239,482
1969.....	274,973,608	11,631,736	134,469,129	2,368,806
1970.....	321,373,389	13,009,547	154,715,609	2,940,279
1971.....	377,184,871	14,802,506	171,901,452	3,594,878
1972.....	414,608,417	15,594,013	186,281,389	3,290,901
Percent.....	210	201	185	612

¹ The Federal Reserve System derives its income from interest received from its government bond portfolio. Monies not spent from this income are returned to the Treasury. Thus, the less money the Federal Reserve spends, the more it returns to the Treasury which reduces the taxpayers' burden of paying for the cost of government.

In order to ascertain whether or not the Federal Reserve System had, on an income basis, curtailed certain unwarranted expenses as officials of the System have continually promised the Banking Committee, the Committee staff reviewed selected expenses of the System for 1972. The two areas in which the Committee staff checked were expenses for travel and a general category listed as "all other".

Included in the "all other" category are such items as membership dues and contributions, athletic activities, social activities and bank relations.

In 1964 travel expenses amounted to \$2.2 million. In 1972, however, these expenses had increased to \$4.8 million.

Insufficient information supplied staff

The staff has found it consistently difficult to monitor the travel expenses of the Federal Reserve banks because of the lack of detailed information provided by the banks to justify these expenses. For instance, an accounting in connection with a travel voucher will simply state the individual's name, the amount of money spent on the trip and will list as the description and reason for the trip, for example, as "travel from New York to Philadelphia and return." No other explanation is given for a majority of the travel expenditures.

Perhaps one of the most interesting areas of the travel section involves the transfer of Federal Reserve employees from one bank to another or expenses paid in connection with the hiring of a new employee to relocate that employee from one location to the city in which the bank that hires the person is located.

In connection with such moves, the Federal Reserve Banks pay virtually all the expenses including visits to the new city by the employee and members of the employee's family to house hunt, as well as providing funds for such items as closing costs on the sale of a house and on the purchase of a new house, utility deposits and funds for temporary living quarters. Although the Federal Reserve reimburses its employees for all such moving expenses it should be noted that these expenses are not authorized for employees of other government agencies. An employee of the Federal Government being permanently transferred to a new duty station is permitted under Public Law 89-516 to make only one trip visit with his spouse to his new duty station at the government's expense for the purpose of house hunting, etc.

It should also be noted that the tax laws provide equitable treatment for individuals who move in connection with a change of jobs or a transfer within the same type of job.

Federal Reserve gives lavish treatment

Despite the restriction on other Federal employees and the provisions of the tax laws, the Federal Reserve is quite lavish in its treatment of expenses in connection with moves.

The following examples illustrate this point quite clearly.

In connection with the expenses of Arthur H. Kanter it should be noted that the Federal Reserve Bank provided funds on several occasions for Mr. Kanter to travel from Atlanta to New Orleans to visit his family. In addition there are other trips from Atlanta to New Orleans for which the bank paid that may possibly have been used for family visits, but this information was not made available in the expense vouchers.

The transfer of M. C. Petersen from the Seattle branch to the Portland branch of the San Francisco Federal Reserve Bank also makes a strong case for a GAO audit of the Federal Reserve System. A Federal Reserve Bank paid \$7,884.90 spread out over sixteen occasions in connection with this transfer. On each occasion the only reason for the payment is listed as "transfer from Seattle branch to Portland branch." It should be noted in connection with this transfer that the Federal Reserve System spent nearly \$8,000 on a transfer of an individual when a distance involved was only 175 miles.

But perhaps the most extravagant expenditures in this area were made in connection with the hiring of Mr. J. J. Bales as President of the San Francisco Federal Reserve Bank. Mr. Bales moved from Pittsburgh, Pennsylvania, to San Francisco, and in connection with this move the Federal Reserve Bank of San Francisco paid \$19,249.18 in four payments over roughly a three-month period. As can be seen from the table, it is virtually impossible to ascertain the reason for all of these expenses except perhaps the payment to the moving company. More than \$14,000 of the \$19,000 total was paid in two payments five days apart in December of 1972. The reason for the payments was listed by the Federal Reserve System as only "Pittsburgh to San Francisco." Certainly an audit of even the most basic type would have required more of an explanation for an expenditure of more than \$19,000 of taxpayers' funds than the barebone descriptions provided by the Federal Reserve System.

EXPENSES IN CONNECTION OF MOVE OF PIERRE VIGUERIE, BANK VICE PRESIDENT, FROM NEW ORLEANS TO ATLANTA

Date	Amount	Payee	Reason	Description
Sept. 11	\$169.87	Mrs. P. M. Viguerie	House hunting in connection with relocation of her husband, P. M. Viguerie.	Trip from New Orleans to Atlanta and return.
Do....	311.74	Mr. and Mrs. P. M. Viguerie.	House hunting.....	Do.
Do....	290.25	do	do	Do.
Do....	256.15	do	do	Do.
Sept. 12	625.00	P. M. Viguerie	Cost incidental to purchase of new home	Moving expenses for transferred officer.
Sept. 15	1,210.53	do	Reimbursement for tax liability as per advisory letter No. 407.	Relocation expenses.
Do....	1,560.50	Security Van Lines Inc.	For household goods and furniture of P. M. Viguerie from New Orleans.	Moving expenses.
Oct. 25	3,358.50	P. M. Viguerie	Closing costs for residence in New Orleans	Relocation expense.
Oct. 27	56.80	Security Van Lines	Covering supplemental moving expense on household goods for Pierre Viguerie from New Orleans.	Do.
Nov. 29	156.19	P. M. Viguerie	Cost of maintenance of home in New Orleans from Oct. 1 to the sale of home on Oct. 17, 1972.	Relocation expense.
Total..	7,955.53			

EXPENSES IN CONNECTION WITH MOVE OF ARTHUR H. KANTER, SENIOR VICE PRESIDENT, ATLANTA FEDERAL RESERVE BANK, FROM NEW ORLEANS

Jan. 3	\$240.00	Peachtree Towers Inc.	Temporary living expenses, transferred officer dislocated from family.	Temporary living expenses.
Jan. 12 ¹	74.22	Arthur H. Kanter	Visit New Orleans Federal Reserve Bank	Trip from Atlanta to New Orleans and return.
Feb. 2	249.48	Peachtree Towers	Rent on apartment for A. H. Kanter for month of February 1972, transferred officer dislocated from family.	Temporary living expenses.
Do....	302.90	Arthur H. Kanter	For A. H. Kanter from New Orleans, Jan. 2-31, 1972, transferred officer dislocated from family.	Do.
Mar. 1	242.77	do	For the month of February 1972 transferred officer dislocated from family.	Do.
Do....	250.85	Peachtree Towers	Rent on apartment for the month of March 1972.	Do.
Mar. 20	298.88	Arthur H. Kanter	Visiting family and attending board of directors meeting.	Trip from Atlanta to New Orleans to Lake Charles, La., and return.
Apr. 3	253.68	Peachtree Towers	Rent on apartment for A. H. Kanter for April 1972.	Temporary living expenses.
Apr. 7	127.82	Arthur H. Kanter	Visit family in New Orleans and visit Jacksonville branch.	Trip from Atlanta to New Orleans to Jacksonville and return.
Apr. 12	458.66	do	Visit family in New Orleans, Mar. 3-6, 1972, and attend Birmingham branch board of directors meeting.	Trip from Atlanta to New Orleans to Birmingham and return.
April 28	110.08	do	Visit to the New Orleans branch	Trip from Atlanta to New Orleans and return.
May 11	252.35	Peachtree Towers	Rent for apartment for A. H. Kanter for May 1972.	Temporary living expenses.
May 26	125.28	Arthur H. Kanter	Moving expense on personal items (\$21.28); airline ticket to visit family on weekend of Jan. 21-23.	Relocation from New Orleans to Atlanta.
June 2	351.00	do	For month of May 1972	Temporary living expenses.
June 7	247.20	Peachtree Towers	Rent on apartment for A. H. Kanter for June 1972.	Do.
June 22	121.49	Arthur H. Kanter	Visit family in New Orleans, June 9-11	Trip from Atlanta to New Orleans and return.
Do....	206.73	do	Move family to Atlanta June 18-20; relocation.	Do.
July 3	21.26	Peachtree Towers	Additional cost to Peachtree Towers for June for A. H. Kanter; additional costs were incurred because of a visit from his wife and daughters June 20-29, 1972.	Temporary living expenses.
July 12	163.50	Arthur H. Kanter	For the month of June	Do.
Do....	2,129.70	do	Cost incidental to selling home in New Orleans and buying home in Atlanta.	Relocation expense.
July 18	1,115.74	Security Van Lines	For household goods and furniture of A. H. Kanter from New Orleans.	Moving expenses.
Total..	7,343.95			

See footnote at end of table.

EXPENSES IN CONNECTION WITH TRANSFER OF J. GUYNN, VICE PRESIDENT NEW ORLEANS BRANCH—FROM MIAMI TO NEW ORLEANS

Date	Amount	Payee	Reason	Description
Aug. 17	\$271.73	J. Guynn.....	Moving expenses.....	Househunting prior to relocation.
Aug. 23	125.79	.....do.....	.....do.....	Househunting and temporary living expenses.
Sept. 11	265.41	.....do.....	.....do.....	Temporary living expenses in New Orleans prior to family relocation.
Do....	349.18	.....do.....	.....do.....	Do.
Do....	305.84	.....do.....	.....do.....	Temporary living expenses prior to family relocation.
Sept. 22	150.00	.....do.....	.....do.....	Appraisal of Miami house.
Oct. 26	1,137.00	.....do.....	.....do.....	Partial reimbursement for tax liability on moving expenses.
Do....	250.00	.....do.....	.....do.....	Moving allowance for misc. expenses.
Do....	4,240.43	.....do.....	.....do.....	Selling costs on Miami home.
Nov. 3	1,951.47	Allied Van Lines.....	.....do.....	J. Guynn's transfer from Miami.
Dec. 29	986.81	J. Guynn.....	.....do.....	Closing costs on purchase of New Orleans home \$712.75. Carrying costs on Miami house to Sept. 15, \$13.06. Final reimbursement for tax liability incurred on moving expenses.
Total..	10,033.66			

MOVING EXPENSES FOR ALAN DAVIS, JACKSONVILLE BRANCH

June 2	\$277.55	Alan Davis.....	Relocation from Atlanta, period May 21-29, per diem and accommodations.	Temporary living expenses including 2 trips to Jacksonville.
June 22	520.49	.....do.....	Relocation from Atlanta office for period May 30, 1972, to June 12, 1972, less 3½ days in Atlanta per diem and accommodations.	Temporary living expenses including trip to Atlanta.
Do....	80.00	.....do.....	Relocation from Atlanta.....	Appraisal of house.
Do....	60.00	.....do.....	Relocation from Atlanta, period June 13, 1972, through June 18, 1972.	Temporary living expense.
July 5	131.63	.....do.....	Relocation from Atlanta office, period June 6, 1972 through June 25, 1972, per diem.	Temporary living expenses including trip to Atlanta.
July 18	85.83	.....do.....	Relocation from Atlanta office, period June 26, 1972 through July 2, 1972, per diem.	Temporary living expenses.
July 24	193.30	.....do.....	Relocation from Atlanta.....	House hunting trip wife and daughter.
Do....	373.93	.....do.....	Relocation from Atlanta, period July 3, 1972 through July 9, 1972, per diem and accommodations.	Temporary living expenses including trip to Atlanta.
Aug. 2	136.72	.....do.....	Relocation from Atlanta, period July 10, 1972 through July 16, 1972, per diem.	Do.
Aug. 3	70.00	.....do.....	Relocation from Atlanta, period July 17, 1972 through July 23, 1972.	Temporary living expenses.
Aug. 9	250.00	.....do.....	Relocation from Atlanta.....	Miscellaneous expenses.
Aug. 10	118.90	.....do.....	Relocation from Atlanta, Aug. 1, 1972 through Aug. 15, 1972 apartment and furniture rent.	Temporary living expenses.
Do.	156.13	.....do.....	Relocation from Atlanta, period July 24, 1972 through July 30, 1972 per diem and accommodations.	Temporary living expenses including trip to Atlanta.
Sept. 8	700.06	.....do.....	Relocation from Atlanta.....	Closing costs of Jax house; taxes, interest, insurance on Atlanta house.
Sept. 18	939.88	.....do.....	.....do.....	Movement of household goods.
Oct. 3	109.65	.....do.....	.....do.....	Trip to Atlanta and miscellaneous expenses to finalize sale of home.
Nov. 1	131.40	.....do.....	.....do.....	Transfer fee and interest on home in Atlanta.
Do.	123.66	.....do.....	.....do.....	Electric service for apartment and interest in connection with purchase of home.
Nov. 15	362.00	.....do.....	.....do.....	Reimbursement for taxes on moving expenses.
Total..	4,821.14			

EXPENSES IN CONNECTION WITH MOVE OF J. J. BALLEES FROM PITTSBURGH, PA., TO
SAN FRANCISCO

Date	Amount	Payee	Reason	Description
Sept. 8	\$883.90	J. J. Balles.....	From Pittsburgh to (San Francisco) and return.	Relocation expenses account transfer to San Francisco.
Nov. 6	4,349.62	Aero Mayflower Trans- sit Co.	Pittsburgh to San Francisco a/c J. J. Balles.	Do.
Dec. 22	8,188.66	J. J. Balles.....	Pittsburgh to San Francisco.....	Do.
Dec. 27	5,827.00	do.....	do.....	Do.
Total..	19,249.18			

¹ Possible visit to family in addition to bank business.

It should be noted that on September 27, 1971, the Domestic Finance Subcommittee held a congressional oversight hearing on the Federal Reserve System and on that occasion Chairman Patman pointed out that there were abuses of expenditure of funds in connection with moving expenses. At that time he placed in the hearings a breakdown of funds paid in connection with a transfer of an employee to the Helena, Montana, branch, of the Minneapolis Federal Reserve Bank. Apparently the Federal Reserve System has paid little attention to correcting the payment of such expenses and in fact has increased such payments as noted by the above examples.

Fed officials deny audit need

In arguing against the need for an audit of the Federal Reserve System by the General Accounting Office, both former Federal Reserve Board Chairmen William McChesney Martin and the current Chairman Dr. Arthur Burns have repeatedly stated that the System has its own adequate audits. For instance, in 1964 Federal Reserve Board Chairman Martin in defending the audit procedures of the Federal Reserve System told the Domestic Finance Subcommittee, "It is difficult to perceive how the GAO or any other audit group could achieve a more effective result." Dr. Burns in an appearance before the Domestic Finance Subcommittee in 1971 pointed out, "The Board has utilized this review period to consider in detail the existing procedures governing expenditures. It has discussed these questions with the President of each Federal Reserve Bank. We have sought to make certain all types of expenditures are carefully reexamined to insure that they can be justified on a cost-benefit basis as contributing to an efficient performance of the reserve bank's functions. The operations of the Reserve banks change constantly over time. We strive to make certain that each expenditure is justified in relation to the existing situation and that no expenditure occurs simply because it may have occurred in the past. . . ." Later in the hearing Dr. Burns said:

"As I made clear at the start we recognize that the Federal Reserve System must always be able to justify any expenditure in terms of its benefits in relation to its cost. We feel certain that with the exception of some obvious cases of human error, the Federal Reserve System does this. I can assure the Congress that along with the Presidents of the Reserve banks and other members of the Board I am personally taking all necessary steps to insure that we get our money's worth on every dollar spent."

Banking dues are still paid

Shortly after the 1971 hearings, Dr. Burns informed Chairman Patman that the Federal Reserve Board was clamping down strongly on any unnecessary expenses and that many of the expenses with which the Committee staff had categorized as unnecessary in earlier years would no longer be allowed. Among these were contributions and membership dues to organizations such as the American Bankers' Association and related state banking associations.

Despite the lofty pronouncements by former Chairman Martin and Dr. Burns there is little to indicate that adequate audit procedures can be performed by the Federal Reserve System or that there have been substantial curtailment of Federal Reserve expenditures. This is quite clearly shown by looking at the expenditures in the "all other" category. In 1964 the "all other" category accounted for \$3,291,617. However, in 1972, only eight years later, the "all other" category has reached \$7,178,125. Included in that figure for 1972 is an expenditure of \$129,727 in the form of Federal Reserve membership dues and contributions. While this represents only a slight increase from the 1964 figure it should be

pointed out that while the Federal Reserve banks and branches no longer pay membership dues directly to the American Bankers' Association and related state banking associations, a substantial expenditure from previous years, the banks still pay membership dues in a number of banking organizations.

In addition the staff has found that although the Federal Reserve Board lists only \$115,917 in dues and contributions in 1972 this figure does not correspond with actual expenditures which more probably should have been charged to the membership dues and contribution account rather than to other accounts. By charging all expenses that should properly belong to the membership dues and contributions account, the staff feels that the total expenditures for 1972 in that category would equal the \$129,727 mentioned above. Of the total figure for membership dues and contributions in 1972, banking organizations accounted for \$80,474.58 of the total with three banking organizations, Bank Administration Institute, American Institute of Banking and Robert Morris Associates, accounting for most of these dues. The American Institute of Banking was the largest single recipient of the Federal Reserve Bank's generosity with taxpayers' funds. The AIB was paid more than \$55,000 in membership dues during 1972. On an individual bank basis the dues ranged from a low of \$280.90 paid by the Houston branch to a high of \$5,984.00 paid by the New York Bank.

The staff study also shows that while Dr. Burns had told Chairman Patman that the banks would no longer pay dues or make contributions to the American Bankers' Association or related state banking associations the practice appears to continue although it apparently has been disguised. For instance, the Dallas Bank shows a \$100 expenditure with the accompanying explanation of "Texas Bankers' Association fee for services performed for Federal Reserve Bank of Dallas and its branches." A \$400 expenditure in the Richmond bank listings is itemized as "North Carolina Bankers' Association 1972 participation fee." However, these two items are pale in comparison to major expenses by the New York and Philadelphia Banks. The New York Bank, for instance, shows an expenditure of \$8,405.39 with the explanation that the money is for "luncheon for New York and New Jersey Bankers' Associations, February 15 and June 9." The Philadelphia Bank lists an expense of \$1,211 with the explanation of "New Jersey Bankers' Association pro rata share, annual luncheon."

Bankers eat well at Fed expense

This expenditure was broken down in the following manner. \$5,211.60 was spent on luncheon served at the annual meeting of the New York State Bankers' Association at the Waldorf Astoria, February 15, 1972. On March 20 and November 28, \$50.00 was spent on each occasion for the printing of tickets for the luncheons in connection with the annual meetings of the New York State Bankers' Association and the New Jersey Bankers' Association. On May 22, 1972, \$25 was paid as "reimbursement to a staff member for an honorarium to a guest clergyman who delivered the invocation at the annual meeting of the New Jersey Bankers' Association." On June 9, \$3,051.59 was paid to the Chalfonte-Haddon Hall in Atlantic City, New Jersey, as "the bank's share of the cost of the luncheons sponsored by this bank and the Federal Reserve Bank of Philadelphia in connection with the annual meeting of the New Jersey Bankers' Association." As pointed out earlier, the Philadelphia Bank's pro rata share of the luncheon was \$1,211. There was an additional expenditure in connection with the New York State and New Jersey Bankers' Association meeting of \$153.35 for the rental of ten tuxedos for various officers and staff members who attended the meetings. While this expenditure, of course, did not benefit directly the banking associations it does represent an extremely questionable expense on the part of the Federal Reserve bank and is only one instance in which hundreds of dollars were spent throughout the Federal Reserve banking system for the rental of tuxedos. It should also be noted that the expenditures in connection with the bankers' luncheon were posted to the research, public information and bank relations category, although it would appear that this money was spent for the benefit of the bankers' association, which would thus be quite properly categorized as dues or contributions.

In addition to the dues paid to various banking organizations the Federal Reserve banks and their branches spent thousands of dollars for membership dues in a variety of organizations and associations. For example, a partial list of the organizations to which the banks pay dues include:

Central Atlanta Progress.
Atlanta Chamber of Commerce.

Rotary Club of Atlanta.
 Special Libraries Association.
 State Bar of Georgia.
 Georgia Association Business Community.
 Atlanta Employment Association.
 Institute of Internal Auditors.
 Association for Systems Management.
 Georgia Association of Credit Management.
 Georgia Society of Professional Engineers.
 Atlanta Society of Financial Analysts.
 American Institute of Industrial Engineers.
 Data Processing Management.
 American Management Association.
 American Nurses Association.
 American Society of Personnel Administration.
 Birmingham Chamber of Commerce.
 Personnel Association of Birmingham.
 National Association of Power Engineers.
 Bank Security Association of Northeast Florida.
 Jacksonville Personnel Women.
 Miami Association of Industrial Nurses.
 Miami Chamber of Commerce.
 Coral Gables Chamber of Commerce.
 Nashville Civitan Club.
 Nashville Chamber of Commerce.
 New Orleans Chamber of Commerce.
 American Statistical Association.
 American Economic Association.
 American Society for Industrial Security.
 American Finance Association.
 Chicago Agricultural Economist Club.
 Operations Research Society of America.
 Northern Illinois Association of Industrial Nurses.
 Association for Computing Machinery.
 Illinois State Bar Association.
 Administrative Management Society.
 Illinois Training Directors' Association.
 Building Managers Association of Chicago.
 International Association of Business Communicators.
 National Industrial Conference Board.
 International Trade Club of Chicago.
 The Chicago Farmers.
 Illinois State Chamber of Commerce.
 American Bar Association.
 Illinois State Bar Association.
 Chicago Association of Commerce and Industry.
 National Association of Business Economists.
 The Institute of Management Sciences.
 Operations Research Society of America.
 Midwest College Placement Association.
 The Institute of Chartered Financial Analysts.
 The Illinois Society of Certified Public Accountants.
 Financial Executive Institute.
 National Tax Association.
 Women in Personnel of Chicago.
 Society of Typographic Arts.
 Illinois Regional Library Council.
 Western Agricultural Economics Association.
 Chicago Industrial Communications Association.
 The Executives Club of Chicago.
 Chicago Guidance and Personnel Associations, Inc.
 The Society for Management Information Systems.
 The Bankers' Club of Chicago.
 Office of Education Advisory Council.
 American Society for Training and Development.
 Purchasing Management Association of Chicago.

Regional Science Association.
 Special Libraries Association.
 Industrial Relations Association of Chicago.
 The Federal Bar Association.
 The Employers Association of Detroit.
 Detroit Area Economic Forum.
 Building Owners and Management Association.
 Michigan State Chamber of Commerce.
 Personnel Women of Detroit.
 Greater Detroit Chamber of Commerce.
 Detroit Industrial Nurses Association.
 Detroit Building Superintendent Association.
 Purchasing Management Association of Detroit.
 Michigan Restaurant Association.
 American Risk and Insurance Association.
 New England Telecommunications Association.
 Tax Institute of America.
 American Industrial Development Council.
 In-Plant Printing Management Association.
 Public Relations Society of America.
 Boston Survey Group.
 The International Center of New England.
 Better Business Bureau of Eastern Massachusetts.
 New England Police Revolver League Incorporated.
 The Women's Personnel Club of Eastern Massachusetts.
 Insurance Company and Bank Purchasing Agents Association.
 Social Law Library.
 American Records Management Association.
 Greater Boston Association of Industrial Nurses.
 The Urban Land Institute.
 Greater Boston Chamber of Commerce.
 Purchasing Management Association of Dallas.
 Southwest Placement Association.
 Dallas Chamber of Commerce.
 New Mexico Mining Association.
 American Management Association.
 Better Business Bureau of Dallas, Texas.
 National Bureau of Economic Research.
 Dallas Personnel Association.
 Committee for Economic Development.
 Marine Technology Society.
 El Paso Chamber of Commerce.
 San Antonio Chamber of Commerce.
 San Antonio Personnel and Management Association.
 Econometric Society.
 Adult Education Council of Greater St. Louis.
 Regional Science Association.
 Southern Agricultural Economics Association.
 Better Business Bureau of Greater St. Louis.
 Western Economic Association.
 Junior Achievement of Mississippi Valley Incorporated.
 St. Louis Regional Commerce and Growth Association.
 Southern Economic Association.
 St. Louis Association of Industrial Nurses.
 Law Library Association of St. Louis.
 Sophia Incorporated.
 Missouri Society of Farm Managers and Rural Appraisers.
 Junior Chamber of Commerce of St. Louis.
 St. Louis Mercantile Association.
 National Bureau of Economic Research Incorporated.
 Richmond Chamber of Commerce.
 Richmond Personnel Executives Association.
 American Dietetic Association.
 Richmond Public Relations Association.
 Richmond Society of Financial Analysts.
 Business Forms Management Association.

Society of American Archivists.
 Virginia Association for Building Management.
 Richmond Personnel and Guidance Association.
 Academy of Political Science.
 Virginia College Placement Association.
 Southeastern Library Association.
 Pennsylvania Bar Association.
 Philadelphia Bar Association.
 Better Business Bureau of Philadelphia.
 National Planning Association.
 Police Chiefs Association of Southern Pennsylvania.
 Chestnut Street Association.
 Pennsylvania Chamber of Commerce.
 Delaware Valley Chapter of American Records Management.
 Philadelphia Committee on City Policy.
 Crime Commission of Philadelphia.
 National Service of Regional Councils.
 Greater Philadelphia Chamber of Commerce.
 Free Library of Philadelphia.
 National Association of Accountants.
 Philadelphia Survey Group.
 Council for Urban Economic Development.
 Credit Management Association of Delaware Valley.
 Philadelphia Book Clinic.
 Philadelphia Association of Industrial Nurses.
 Pennsylvania Institute of Certified Public Accountants.
 Association of Records, Executives and Administrators.
 Population Association of America.
 National Association of Credit Management, Northern and Central California.
 San Francisco Junior Chamber of Commerce.
 Bay Area Personnel of Women.
 San Francisco Chamber of Commerce.
 Real Estate Research Council of Northern California.
 Salt Lake Area Chamber of Commerce.
 Salt Lake Jaycees.
 Portland Chamber of Commerce.
 Portland Junior Chamber of Commerce.
 Portland Chapter, Pacific Northwest Personnel Management Association.
 Southern California Industrial Nurses Association.
 Residential Research Committee.
 Seattle Chamber of Commerce.
 Greater Cleveland Growth Association.
 The Journal of Economic History, New York University.
 The Cleveland Law Library.
 Cleveland Compensation Association.
 Ohio State Bar Association.
 Purchasing Management Association of Cleveland.
 Greater Cincinnati Chamber of Commerce.
 Cincinnati Better Business Bureau Inc.
 Chamber of Commerce of Greater Pittsburgh.
 The Bankers' Club of Pittsburgh.
 Pittsburgh Personnel Association.
 Kansas City Stewards, Chefs, Caterers Association.
 Bankers Consumer Credit Association.
 Lawyers Association of Kansas City.
 Associated Industries of Missouri.
 Mid-Continent Research.
 Kansas City Press Club.
 Kansas City In-Plant Printing Club.
 Rocky Mountain College Placement Association.
 Citizens Environmental Council.
 Personnel Research Forums.
 Greater Kansas City Association of Nurses.
 Bank Security Officers Association.
 Women's Chamber of Commerce.
 Regional Science Association.

Chamber of Commerce of Greater Kansas City.
 Kansas City Wholesale Credit Association.
 Kansas City Bar Association.
 Missouri Restaurant Association.
 Missouri Bar Association.
 Kansas City Business Communicators.
 Colorado Society for Personnel Administration.
 Denver Chamber of Commerce.
 Colorado Personnel Women.
 Colorado Association of Industrial Nurses.
 Oklahoma City Personnel Association.
 Better Business Bureau of Oklahoma City.
 Personnel Association of Omaha.
 Omaha Chamber of Commerce.
 National Industrial Cafeteria Managers' Association.
 Government Bond Luncheon Group.
 American Academy of Occupational Medicine.
 Money Market Luncheon Group.
 New York Personnel Management Association.
 Forex Club of America.
 Institute of Sanitation Management.
 Chamber of Commerce of the State of New York.
 Industrial Medicine Association.
 New York Law Institute.
 American Foreign Law Association.
 Treasury Security Luncheon Club.
 Financial Purchasing Agents Conference (Greater).
 Building Owners and Managers Association of New York.
 The Association of the Bar of the City of New York.
 Federal Statistics Users Conference.
 New York Association of Compensation Administrators.
 New York Financial Writers Association.
 Beekman Downtown Alumni Hospital Association.
 The Money Marketeers.
 National Secretaries Association.
 Metropolitan Economic Association.
 Industrial Recreation Directors' Association.
 Downtown Economists Luncheon Group.
 Bank Credit Associates of New York.
 Dental Hygienists Association.
 College Relations Council of New York.
 Bank Operations Conference of New York City.
 Greater New York Association of Industrial Nurses.
 Ambassadors Club of Trans World Airlines.
 Buffalo Chamber of Commerce.
 Industrial Relations Association of Buffalo.
 Building Owners and Managers Association of Buffalo.
 Western New York Association of Industrial Nurses.
 Minneapolis Association of Building Owners and Managers.
 Minnesota State Association of Industrial Nurses.
 Associated Industries of Minneapolis.
 American Agricultural Economics Association.
 Minneapolis Chamber of Commerce.
 Upper Midwest Chapter of the Institute of Management Sciences.
 Minnesota State Bar Association.
 Credit Bureau of Minneapolis.
 St. Paul Chamber of Commerce.
 North Central Credit and Financial Management Association.
 Minnesota Association of Industrial Nurses.
 Twin City Personnel Association.
 Montana Stock Growers Association.
 Helena Chamber of Commerce.

It is difficult to justify these expenditures or dues particularly when a majority of the dues are for individual bank officers and employees. It would appear that

the payment of dues is more of a fringe benefit for the employees than a direct benefit to the operations of the Federal Reserve banks. It should also be noted that other government agencies are prohibited from paying employees' dues to any type of organization.

Table II is a breakdown of the dues paid by each bank and branch during 1972.

TABLE II—1972 DUES AND CONTRIBUTIONS OF THE FEDERAL RESERVE BANKS AND BRANCHES

	BAI	AIBL	RMA	Other	Total
San Francisco.....	\$550.00	\$2,905.00	\$415.00	\$175.00	\$4,970.00
Salt Lake.....	60.00	120.00	40.00	90.00	495.00
Los Angeles.....	65.00	1,556.60	30.00	-----	1,773.60
Portland.....	45.00	762.91	30.00	-----	1,012.91
Seattle.....	45.00	362.28	30.00	-----	537.28
St. Louis.....	525.00	2,441.25	400.00	-----	8,256.25
Little Rock.....	60.00	-----	22.50	-----	437.50
Memphis.....	60.00	356.04	15.00	25.00	781.04
Louisville.....	85.00	-----	22.50	65.00	384.50
Atlanta.....	500.00	4,086.33	460.00	60.00	7,369.83
Birmingham.....	145.00	828.71	-----	-----	1,307.46
Jacksonville.....	70.00	-----	-----	25.00	147.00
Miami.....	45.00	612.00	-----	-----	951.00
Nashville.....	60.00	992.38	-----	-----	1,350.44
New Orleans.....	80.00	1,050.00	-----	35.00	1,422.00
Cleveland.....	530.00	2,147.34	409.00	-----	4,392.34
Cincinnati.....	35.00	289.00	-----	-----	703.30
Pittsburgh.....	52.00	-----	10.00	175.00	536.00
Dallas.....	670.00	2,994.61	430.00	100.00	6,255.41
El Paso.....	43.75	-----	20.00	-----	218.75
Houston.....	35.00	280.90	20.00	-----	335.90
San Antonio.....	43.75	393.16	20.00	-----	393.16
Chicago.....	525.00	4,622.00	525.00	85.00	12,119.00
Detroit.....	60.00	1,963.19	61.00	-----	6,145.09
Boston.....	520.00	2,972.50	470.00	-----	6,060.00
New York.....	560.00	5,984.00	552.50	8,405.39	16,187.75
Buffalo.....	50.00	1,599.34	30.00	-----	2,222.84
Kansas City.....	515.00	3,800.71	400.00	10.00	6,799.21
Oklahoma City.....	45.00	-----	15.00	-----	195.00
Omaha.....	45.00	598.40	15.00	-----	1,105.40
Denver.....	50.00	1,452.59	23.00	-----	1,835.59
Minneapolis.....	680.00	5,943.63	550.00	25.00	10,539.63
Helena.....	42.00	-----	-----	-----	117.00
Richmond.....	520.00	2,872.82	475.00	400.00	6,296.82
Charlotte.....	38.50	254.00	30.00	-----	558.50
Baltimore.....	105.00	1,206.00	25.00	5.00	1,876.50
Philadelphia.....	540.00	-----	490.00	1,211.00	4,043.00
Total.....	8,100.00	55,447.69	6,035.50	10,891.39	129,727.39
Total, all banking dues.....	-----	-----	-----	-----	80,474.58

Symbols denote: BAI—Bank Administration Institute; AIB—American Institute of Banking; RMA—Robert Morris Associates.

¹ Texas Bankers Association fee for services performed for Federal Reserve Bank of Dallas and its branches.

² \$8,389.39 luncheon for New York and New Jersey Association, Feb. 15 and June 9.

³ North Carolina Bankers' Association 1972 participation fee.

⁴ \$1,206 New Jersey Bankers' Association pro rata share annual luncheon.

TABLE II-B.—Membership dues and contributions by years

Membership dues and contributions:	Amount
1964.....	\$129,380
1965.....	131,232
1966.....	128,135
1967.....	134,168
1968.....	140,636
1969.....	156,675
1970.....	166,273
1971.....	119,112
1972.....	129,727

¹ FRB lists only \$115,917.

Athletic, social and recreational activities

In 1972 the Federal Reserve Banks and their branches spent nearly a quarter of a million dollars on athletic, social and recreational activities. The largest expense, \$113,658 was for social and recreational activities while \$17,761 was spent on athletic activities. In addition to these amounts \$85,032 was spent in a form of contributions to various Federal Reserve Clubs throughout the Federal Reserve Bank and Branch System. The Federal Reserve Clubs are operated for the employees of most of the banks with the bank providing a percentage of the funds to operate the clubs. For the most part the clubs' chief expenditure appears to be for various social activities. It is difficult, however, to determine how these clubs spend their money, since the Federal Reserve System has refused to allow the staff of the Banking Committee to look at the expenditures of the clubs. The Federal Reserve takes the position that once the money is turned over to the clubs it is theirs to spend and these expenses should not be reviewed by the Committee staff. Not all of the Federal Reserve banks and branches have Federal Reserve clubs, but among those banks that do have such clubs the amounts contributed to these organizations range from as little as \$33 paid by the Seattle branch of the San Francisco Bank to \$15,000 given to the Federal Reserve Club of Boston. Table III indicates the amount of money spent in the way of contributions to both the Federal Reserve Club and in the area of Athletic and Social and Recreational Activities.

TABLE III

	Federal Reserve club	Athletic activities	Social and recreational activities
1964	\$47,550	\$14,937	\$85,676
1965	45,725	12,259	70,482
1966	41,322	13,831	66,518
1967	43,697	12,890	76,603
1968	43,429	24,105	77,714
1969	48,690	15,079	98,090
1970	58,704	15,166	98,942
1971	78,833	18,816	94,690
1972	85,032	17,761	113,658

Fed clubs lend country club atmosphere

When Dr. Burns appeared before the Domestic Finance Subcommittee in 1971, he defended money being spent on the Federal Reserve Club by telling the Subcommittee, "Employee clubs are an effective employee relations tool in common use in and out of government."

While the use of such clubs may be commonplace in private industry and while employee clubs do function in government, there is quite a major difference when contrasted to the Federal Reserve Club. Athletic and social clubs in the Federal Government are funded entirely by employee contributions and no taxpayers' money is used in these clubs as is used in the Federal Reserve Clubs.

A review of the expenses in the Social, Recreational and Athletic categories appears to paint the Federal Reserve System with virtually a country club atmosphere as these samples of expenditures reveal: The Chicago Federal Reserve Bank spent \$4,600 with the Shubert Theatre for tickets for the Women's Employees Annual outing. That same bank also spent \$3,256.36 for the purchase of supplies and food for the employees annual card party. The San Francisco Federal Reserve Bank spent \$4,400.00 for the Christmas dinner party; \$300 as partial payment for tickets to baseball games; and \$900 for part payment for the spring dance party.

The Salt Lake City Bank spent \$145.78 for bowling shirts and \$2,047.95 for social events, the nature of which is unspecified in the bank's expense vouchers.

The Portland Federal Reserve Bank lists an expenditure of \$250 for beach cabin rental and \$1.39 for flash bulbs for the Women's Banquet.

The Seattle bank lists expenditures of \$424.05 for underground tour for 24 employees and 13 guests; \$37 for partial payment for boat cruises for 23 employees and 46 guests; \$333.05 partial payment for ski outing attended by 16 employees and 20 guests. It should be noted that in two of the three expenditures there were more guests than there were employees. The Seattle bank also spent \$231.68 for women's softball equipment including \$18 for tournament fees.

A ping pong ball in every pocket

The Dallas Federal Reserve Bank might not have the best ping pong players in the Federal Reserve System but it spent the most money in that area. During 1972 the Federal Reserve Bank of Dallas bought 1,152 ping pong balls costing \$155.74. Since the Dallas Federal Reserve Bank has only 895 employees it means that theoretically there was more than one ping pong ball purchased for every employee in the bank. The bank also purchased during the year 29 ping pong paddles.

While Dallas may claim the ping pong expenditure championship, the art award goes to the Philadelphia Bank. During 1972 the bank spent \$1,302 for an instructor for the Art Club plus an additional \$529 on art supplies including \$154 for flowers for the art show. An additional \$81 was spent for luncheons for the Art club while \$25 was spent for subscriptions to the publications "Art in America" and "American Artist." The Philadelphia Bank also showed its interest in art by spending \$23 to observe sculptors in connection with art purchases for the new building. And Philadelphia did not overlook the golfers of the banking staff. The bank spent \$1,478 on golf tees during 1972.

If Dallas claims the ping pong championship and Philadelphia the art award, then the music citation must surely go to the Richmond bank. During 1972 the bank spent a total of \$1,410.63 in connection with the bank's choral group; \$750 was in the form of salary to the choral director with \$490 going to the choral group's accompanist. There was also an expenditure of \$170.63 for music for the choral group. A survey of the bank's monthly expenses shows that apparently the bank was more vocal in some months than in others. For instance, in June the choral director was paid only \$15 and the accompanist \$10. However, during May the director was paid \$150 and the accompanist earned \$100. The Richmond bank also spent \$680.27 for sports equipment, uniforms, and league entry fees.

Baltimore wins the bingo prize. That bank spent \$160.39 on prizes and supplies for the annual employees council bingo party. In addition the bank spent \$50 for a fashion show sponsored by the employees council.

The New York Federal Reserve Bank spent \$2,168.46 for maintenance of its bowling alleys and \$598.06 for a golf tournament. The Buffalo Federal Reserve Bank spent \$270.42 for the visit of the President and Vice President of the Federal Reserve Club of Buffalo to the head office to confer with officers of the Federal Reserve Club of New York and with head office staff members regarding employee relations activities.

Kansas City spent \$225.45 as 10% of the ticket costs to Starlight Theatre productions and \$152.63 for miscellaneous camera equipment and supplies of the bank's camera club.

Flowers not unnoticed by Federal Reserve Banks

While some banks seem to steer the taxpayers money towards art training, musical appreciation, and ping pong events, all of the banks are united in their fondness for flowers. During 1972 the Federal Reserve banks and their branches spent \$10,672.33 on plants and flowers. This total does not include Christmas or other holiday special decorations. The New York Federal Reserve Bank spent the most money on flowers, \$1,708.65, while Oklahoma City spent only \$10 in this area.

If Christmas decorations were added to the flower total, then the expense would increase by more than \$3,500 since the New York Federal Reserve Bank spent \$3,563.88 on Christmas decorations. In the area of Christmas decorations, the banks should perhaps exchange information so as to reduce their costs. For instance the Richmond Federal Reserve bank purchased four Christmas trees for a total of \$110. However, the Louisville bank purchased only one Christmas tree but spent only \$12. Perhaps in the future Louisville could act as a purchasing agent for all Christmas trees throughout the Federal Reserve System.

There are many other areas in which the Federal Reserve banks and their branches are spending thousands of dollars on highly questionable expenses. The following is a listing of expenses considered questionable by the Banking and Currency Committee staff. This list by no means is intended to be all inclusive but rather only highlights some of the questionable expenses. Because of limited detail on other expenses it is impossible to ascertain their validity. In connection with these expenses the staff is mindful of Dr. Burns' statement that along with

the Presidents of the Reserve banks he is taking "all necessary steps to insure that we get our money's worth on every dollar spent." The purpose of these expenditure listings was not to determine whether or not the Federal Reserve obtained value for their dollars, but rather whether or not the money was a legitimate expense. For instance, a \$15 expense for a golf fee may have been worth that amount of money to the person playing depending upon the condition of the course, but at the same time, the staff questions whether that expenditure regardless of the value received is a legitimate expense for an agency of the government.

St. Louis

\$12.22 paid to the Stadium Club for dinners for one officer and one eagle scout guest in connection with the National Public Speaker's contest of the Boy Scouts of America.

\$50 paid to the Bel Air East Hotel for a luncheon meeting of the Eagle Scout Free Enterprise Day attended by 9 Eagle Scouts and 1 employee.

The St. Louis Bank also lists \$696.30 in 176 separate entries with the only notation given "luncheon for bank guests." There is also a listing of \$2,586.72 given as supplemental retirement allowance to Delos C. Johns. This amount is broken down on a monthly payment basis. While this may be a bona fide expenditure the staff wonders why payments to this individual were not made out of the Federal Reserve's pension plan.

Louisville

\$13.86 to Kunz's Pipe Shoppe as miscellaneous expenses in connection with payments mechanism luncheon.

\$3.50 to Spalding College for United Nations Day Dinner attended by one officer.

\$13.13 luncheon for one officer and four guests incident to meeting related to Scout Trust Fund Committee.

New York

\$17.50 to Trans World Air Lines and \$30 to Pan Am Air Lines with the explanation that these are services rendered to Alfred Hayes, President of New York Bank in connection with his domestic and international travel for the bank covering the period August 1, 1972 to July 31, 1973.

\$28.70 for participation by an officer at the 51st Annual Convention of the New York State Movers and Warehousing Association held in Cooperstown, New York.

\$128.75 for a course "Advance Topics in Numerical Analyses" at the University of California, Los Angeles.

\$195.87 for a work shop entitled "The Role of Training Professionals as an Internal Consultant."

\$439.09 for six people to attend a National Exposition of Contractual Interior Furnishings held in Chicago.

There was an additional expenditure of \$608 for travel in connection with this meeting. \$94.35 for attendance by an officer at the Williamsburg Conference on social structure, family life styles, and economic behavior sponsored by the Institute of Life Insurance.

\$20.39 entertainment by officers of a representative from Fortune Magazine.

\$35 for a plant purchased to decorate an office of a Vice President.

\$7,236 paid to a Gardner Cox as a fee for painting a portrait of the President of the New York Federal Reserve Bank.

\$19 as reimbursement to a staff member covering the reported disappearance of personal property check in the Bank Security Check room.

\$55 as reimbursement to a member of the bank's art class covering the disappearance of art supplies while in the custody of the building services division of the bank.

\$275 for the rental of a Hammond Organ.

\$2,897.32 for a kiddie's party.

\$8,428.76 for a Christmas lunch

\$30.51 for ten carat gold keys for three employees who graduated from the American Institute of Banking.

Buffalo

\$2,698.50 for a picnic.

\$2,893.23 for a Christmas dinner plus an additional \$75.40 spent for dinners for those who missed the original Christmas dinner.

Chicago

\$5 for speeches by a bank officer to the Jewell Tea Company Executives.

\$5.52 for attendance of bank employee at the Harper College Seminar on "Improving Coaching and Development."

\$27.15 for cigars for the Board of Director's meeting.

\$104 for registration fee for bank employee attending the Convention of the Society of Automotive Engineers.

San Francisco

\$16.85 attendance by staff members at the Annual Pacific Bankers' School Alumni dinner.

\$2 attendance at Radiological Defense officers' conference.

Salt Lake

\$8.38 for Vice President and Assistant Vice President to attend Chamber of Commerce luncheon meeting on crime prevention.

\$51.50 paid on six different occasions for dues and membership meetings for the Junior Chamber of Commerce in connection with the membership of D. S. Hawkins, Supervisor of the High Speed Check Processing Department.

Los Angeles

\$18.68 reimbursement for luncheon for Mrs. Balles and Mrs. Wilson, wives of President Balles and Chairman Wilson.

\$5 damage to purse by removal of visitation sticker.

It should be noted that while the staff considers the payment of damage caused by Federal Reserve employees or property of the bank to be bona fide that this type of expenditure has occurred in a number of occasions over the years and it may well be that the Federal Reserve System should look into the use of some other type of visitor sticker.

Houston

\$3 cost of two certified copies of death certificates for retired employee.

Minneapolis

\$100 registration fee to attend International Design Conference in Aspin, Colorado.

\$72.05 for the rental of formal attire for graduates of the American Institute of Banking School in connection with the graduation dinner.

Kansas City

\$2,805.11 for the Halloween-Thanksgiving-Christmas parties.

Boston

\$8.30 paid in three installments for travel expenses of an officer for work on Saturday.

\$5.65 for entertainment at the Quarter Century Club Annual Dinner.

\$25.20 for one rosewood gavel with sterling silver band for Quarter Century Club President.

\$722.92 for the attendance of an employee at the IBM School on Selectric typewriters.

\$3 cost of cleaning chauffeur's uniform.

The staff reemphasizes that the above expenditures represent only a handful of the questionable spending of taxpayers' money by the Federal Reserve banks. In each bank and branch there were a large number of such expenses, but rather than list all of these expenses the staff sought to pick out as many different types of questionable expenditures rather than repeat the same type of expense for each bank or branch.

Federal Reserve Thrift Plan

In addition to the multitude of employee benefits available to those working for the Federal Reserve banks and their branches, there is also a highly profitable thrift plan to which employees may belong. The following memo about the plan written to Chairman Patman outlines exactly how the plan operates and why so many Federal Reserve employees have taken advantage of it.

U.S. HOUSE OF REPRESENTATIVES,
 COMMITTEE ON BANKING AND CURRENCY,
 Washington, D.C., August 23, 1973.

Memorandum to: Chairman Patman.
 From: Curtis Prins.
 Subject: Federal Reserve Thrift Plan.

1. The current Federal Reserve thrift plan was begun on January 1, 1970, replacing an annuity account program that the Board had had under operation since 1934.
2. At the time the thrift plan began, \$45 million, the balance in the annuity plan was transferred from that plan to the thrift plan account.
3. The entire amount in the transferred \$45 million was all money contributed to the annuity plan by the employees plus the interest that had been earned on the funds by the investments. There were no funds from the Federal Reserve System included in the \$45 million transferred.
4. When the \$45 million was transferred into the thrift plan, the Federal Reserve did not provide any type of matching or additions to the thrift plan passed on the \$45 million.
5. There are now 17,700 Federal Reserve employees who are members of the thrift plan out of a potential of about 20,000 employees.
6. The current assets of the plan are \$79,819,000 (including the transfer of \$45 million from the former annuity account plan).
7. Of the total assets of \$79,819,000, the Federal Reserve System has contributed \$6,822,000, an increase of \$1,595,000 over the December 1, 1972 figure.
8. For every dollar that an employee contributes to the thrift plan, the Federal Reserve System puts \$.25 into the plan.
9. There is a limit of \$750 per year per employee that the Federal Reserve will contribute to the plan.
10. In addition to the money that is eligible for the \$.25 contribution by the Federal Reserve, an employee can deposit an additional 10% of his salary in the plan. The 10% is not in any way matched or contributed to by the Federal Reserve System.
11. For example, if one of the Federal Reserve employees (such as a Federal Reserve Bank president) makes \$50,000 per year, he could deposit \$3,000 in the thrift plan which would have the added maximum contribution of \$750 added by the Federal Reserve System. In addition to that, this employee could place 10% of his salary or \$5,000 in the plan which would not receive any contribution from the Federal Reserve System. In this example, the maximum amount that the employee could place in the plan would be \$8,000. But only \$3,000 would be subject to the \$.25 per dollar Federal Reserve contribution.
12. The money in the thrift plan is invested in a variety of ways. Approximately 80% of the thrift plan assets are invested with the Equitable Life Assurance Society which has a contract with the thrift plan providing for a guaranteed annual return of 8% for the plan through December 31, 1974.
13. The remaining 20% of the fund's assets are invested with various mutual funds, the Prudential Life Insurance Company and the Co-Mingled Pension Trust Fund of the Morgan Guaranty Trust Company.
14. In addition to the thrift plan, the Federal Reserve System, including employees of the Federal Reserve Board here in Washington, has a pension plan.
15. The pension plans are funded 100% by the Federal Reserve System, which means that the employees do not have to make any contribution to their pension plan.

ARMORED CAR AND CHECK COURIER SERVICE

One of the major expenses of the Federal Reserve System each year is the service provided free of charge to member banks in connection with check courier service and coin and currency distribution. In 1972, the Federal Reserve System spent more than \$36 million in this area. Most of this service should have been paid for by the member banks rather than by the Federal Reserve System. While some of the Federal Reserve Banks maintain their own armored cars, normally these cars are not used to distribute coin and currency but for the most part are used to pick up mail at a central post office due to the limited number of mail deliveries in various cities which are not adequate enough to meet the needs of the System.

Since only a few of the Federal Reserve Banks have their own armored cars and these cars are not used for coin and currency shipments, the transportation of currency and coin both to and from the Federal Reserve banks is accomplished

by using privately owned armored cars, couriers, or other transportation services. Present policy of the Federal Reserve Bank is to pay the transportation expense on all shipments of coin and currency between the reserve banks and member banks outside of Federal Reserve cities. To accomplish this, the Reserve banks use various armored car services and to an extremely limited extent the Post Office Department. In the collection of checks the Federal Reserve Banks once again use private carriers to a large extent and to a much smaller extent the Post Office Department. The cost of transporting the checks for payment is borne entirely by the Federal Reserve Banks. It is interesting to note that not only does the Federal Reserve System pay for the cost of shipping currency to and from member banks but in many cases the Federal Reserve System bears the cost of shipment of currency from one member bank to another member bank and even to offices of the same bank. For instance, if the branch of Bank A wanted to ship currency to another branch of the same bank this could be done with the Federal Reserve System absorbing the cost. Table IV shows the amount of money spent on armored car and check courier service by the Federal Reserve System for each year from 1964 to 1972. The amount of money in this category has increased at such a rapid rate that it is time that the Federal Reserve System reevaluate its thinking of providing this service without charge to the member banks.

TABLE IV.—*Expressage*

Armored car and check courier service:	<i>Amount</i>
1964-----	\$12, 999, 869
1965-----	14, 498, 530
1966-----	16, 712, 252
1967-----	18, 724, 743
1968-----	20, 824, 980
1969-----	22, 815, 922
1970-----	25, 755, 291
1971-----	30, 653, 254
1972-----	36, 537, 061

The CHAIRMAN. Before hearing from our witness, I would like to make one final observation.

Last year, this committee passed a GAO audit bill, but the legislation was attached as an amendment to another bill which did not reach the floor because we were unable to obtain a ruling due to the lateness of the session.

Thus, H.R. 10265 is merely legislation to ratify the committee's earlier action.

Our witness this morning is Gov. George W. Mitchell, Vice Chairman, Board of Governors of the Federal Reserve System.

Governor Mitchell is the only witness we have scheduled today, and tomorrow we will meet in executive session as heretofore agreed upon, at 10 o'clock tomorrow morning, to mark up the bill.

Governor Mitchell, we are delighted to have you, sir, and you have a prepared statement, and you may proceed in your own way, and if you do not deliver all your statement, the rest of it will be inserted in the record.

**STATEMENT OF GOV. GEORGE W. MITCHELL, VICE CHAIRMAN,
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
ACCOMPANIED BY FREDERIC SOLOMON, DIRECTOR, DIVISION OF
SUPERVISION AND REGULATION, BOARD OF GOVERNORS, FED-
ERAL RESERVE SYSTEM**

Mr. MITCHELL. Very well, Mr. Chairman.

Mr. Chairman and members of the committee, I welcome the opportunity you have afforded me to discuss H.R. 10265, a bill which would amend the Federal Reserve Act in various respects.

Section 1 of the bill would authorize the General Accounting Office to conduct an annual audit of the Board of Governors, the Federal Reserve Banks, and their branches. In so doing, the Comptroller General would be accorded access to such records, including reports of examinations of member banks, as he finds necessary for the conduct of the audits. The Comptroller General would be required to submit a report of each audit to Congress.

Section 2 of the bill would extend the authority of the Reserve Banks to purchase obligations of the United States directly from the Treasury. The Banks are currently permitted to purchase up to \$5 billion of U.S. Government obligations in this manner, but this authority expires on October 31.

Section 3 of the bill would raise by \$60 million the ceiling on expenditures which the Federal Reserve System may undertake for the construction and renovation of branch bank buildings.

The Board supports the objectives of sections 2 and 3; I shall comment on these provisions briefly at the end of my statement.

As we understand section 1, the Comptroller General would be granted broad authority to look into the financial and operational aspects of the Federal Reserve System. The GAO would be unrestricted in the conduct of the audit, and would thus have the authority to review and evaluate all aspects of Federal Reserve activities.

The Board of Governors over the years has consistently opposed such proposals. It is understandable that some Members of Congress and the public have wondered at this, since the General Accounting Office enjoys a well-deserved reputation for competence and integrity. I submit to you, today, however, that we perceive serious problems with this proposal. Our objections stem from a basic concern about the optimal functioning of the Nation's money and banking system. With your permission, I'd like to briefly sketch in the background on this subject.

Congress created the GAO in 1921—8 years after passing the Federal Reserve Act—to provide the legislative branch with audit authority over the receipt, disbursement, and application of public funds. For the next 12 years, the Board of Governors, but not the Federal Reserve banks and branches, came under the GAO's scrutiny. During this time, the accounts of the Board were carefully checked by GAO.

In 1933, however, Congress deliberately voted to remove the Board from the jurisdiction of the GAO. The purpose, as described in the report of the Senate Banking and Currency Committee, was to "leave to the Board the determination of its own internal management policies." This action, we believe, resulted from a judgment that non-interference with the internal management of the Federal Reserve would in the long run provide better monetary and credit policies.

Naturally, the audit function did not cease with the termination of the GAO's annual audits of the Board. For some years, audit teams from nearby Federal Reserve banks performed the audit of the Board's books, but in 1952, the Board, using the discretion Congress provided, voted to hire nationally recognized public accounting firms to perform this function in order to assure an independent oversight of the Board's administrative activities. This arrangement has continued

to this day. Meanwhile, year in and year out, the Board's own examiners scrutinized the Federal Reserve banks. In recent years, their techniques have been reviewed by outside accountants.

Before describing our present audit procedures in detail, I should like to refer to the types of audit work which we understand GAO conducts. I should add that, although the distinctions may seem to be clear from a conceptual standpoint, they tend to overlap in practice.

The audit of narrowest scope is termed by the GAO as an audit of financial operations and legal compliance. This is an audit of financial transactions, accounts and reports and of compliance with applicable laws and regulations.

A second category of audit relates to efficiency of operation. Policies, procedures, and transactions are examined to evaluate how well the agency carries out its programs and activities and how well it uses its financial, property, and personnel resources.

The third category of audit deals broadly with program results—the extent to which desired results or benefits are being achieved and whether the objectives established by Congress are being met.

For its part, the Federal Reserve System has developed formal audit and examination procedures which are extremely thorough. The accounts of the Board of Governors are audited each year by a competent outside accounting firm of certified public accountants. Each accounting firm performs audits for 5 successive years, and is then replaced by another top-flight firm. Last year, the audit was conducted by Touche Ross & Co.; the preceding year, it was conducted by Lybrand, Ross Bros. & Montgomery, which ended a 5-year cycle. Their audit report is reproduced in the Board's annual report, and copies of the report are furnished to this committee and to the Senate Committee on Banking, Housing and Urban Affairs.

Each Federal Reserve bank and branch is examined at least once each year by the Board's staff of field examiners. The examination includes a comprehensive review of each bank's expenditures to determine if they are properly controlled and of a nature appropriate for a Reserve bank. The outside accounting firm retained to audit the Board is engaged to accompany the Board's examiners on their examination of one of the Reserve banks each year. This provides an external evaluation of the adequacy and effectiveness of the examination procedures.

In addition to the annual examination by the Board's examiners, the operations of each Reserve bank are audited by the Bank's internal auditing staff on a year-round basis under the direction of a resident general auditor. He is responsible to the bank's board of directors, through its chairman and its audit committee, and his selection is approved by the Board of Governors. He is thus independent of the bank's operating management. Each year, the Board's examiners review thoroughly the resident audit programs at all the Reserve banks to see that the coverage is adequate and the procedures effective.

Thus the auditing controls set up by the Federal Reserve begin with onsite auditors, independent of management, who review daily operations, security procedures, and conformance with System standards. Their constant presence provides continuous auditing and timely action.

The followup of the onsite activity is made by the Board's examiners in their examinations of the Reserve banks. These are backed up by an over-the-shoulder inspection by the outside auditors of the work of the Board's examiners in examining a typical Reserve bank. This is to bring current expertise over a broad range of accounting problems and auditing developments to that of the Board's examiners.

The System taken all together is thoroughly adequate and may even seem redundant. If one were to review audit findings and recommendations over the years, I doubt if he could come to any other conclusion. Over the years, most of the potential problems have been dealt with by resident auditors, and at no time in history has the internal auditing program of the Reserve banks been stronger than it is today.

But thoroughness is necessary because the Federal Reserve banks deal in the most fungible of all commodities—money—and in astronomical quantities. The Reserve banks handle an annual flow of coin and currency of 27.8 billion pieces having a value of \$53.2 billion. The checks passing through the System each year on their way to becoming someone else's money total 9.8 billion items and \$3.7 trillion. The wire transfers are limited in number only—only 11 million were handled last year, but they moved \$17 trillion. To perform these functions with a minimum loss or defalcation requires a comprehensive control and audit system. No system is perfect, but ours has worked well, as the record shows.

In recent years, the term "audit" has been broadened, as the GAO concepts indicate, to include a variety of objectives and techniques. I think it is clear from the description of Federal Reserve audit activities that I have given thus far that I have focused on what is generally called an audit of financial transactions. Such an audit of the Federal Reserve banks covers:

- (a) The system of recordkeeping and accounting control over money, checks, and securities coming into and going out of the Reserve banks, as well as their expenses, earnings, assets, and liabilities;
- (b) The compliance with basic standards—in this case Federal law, and regulations and directives of the Board of Governors; and
- (c) The availability of periodic reports summarizing the financial data in a manner which reveals the volume of work, relevant costs, and the net earnings (or losses) from operations.

I have spoken in detail about items (a) and (b) but have given little attention to (c). The reason is that our release of data about Federal Reserve operations on a daily, weekly, monthly, quarterly, annual, and ad hoc basis is enormous. For your information, a copy of the Board's publications list follows my statement.

Frequently, as you know, members of the Board testify fully at congressional hearings on the policies and activities of the Federal Reserve System. The Board reports promptly and fully to special congressional inquiries, particularly inquiries by congressional committees involving the System's operations, policies, and expenditures.

Over the years, however, the System's audits have evolved considerably beyond the basic audit of financial transactions which I have described. The System now has in place the capacity to conduct reviews of management and operational efficiency. In some banks, the

independent auditor performs this function; in other cases, it is handled by a separate division under the Reserve bank president. In either event, Reserve bank operations are exposed to a continuous review and evaluation by an extradepartmental unit.

Again paralleling the external arrangements for audits of financial transactions, the Board has a Division of Federal Reserve Bank Operations which reviews the management and operational efficiency of the various facets of Reserve bank operations. Many of these audits are a vehicle for sharing valuable experience among Federal Reserve banks on such matters as check or money handling equipment and procedures. System committees of technicians provide still another arrangement for reaching the results sought by an audit of operations. These committees have provided much of the leadership and know-how for developing many innovations in various operations pertaining to securities handling (book entry), currency sorting, and check and wire transfers.

Finally, some of the Reserve banks have used the services of private consulting firms to review the adequacy and efficiency of their operations. Such external reviews have been productive in evaluating the kinds of operations to which the consultant brings a special expertise. However, we have not found them to be very helpful when addressed to operations that are essentially unique to the Federal Reserve.

Stating our position at the cost-benefit level, the results from internal audits of operations have been much more productive than external audits. This seems to be due to the fact that a large sector of Federal Reserve bank operations has a limited counterpart in public or private institutions either in character or scale. As a result, "outside" experts do not get much beyond the learning stage in their audits of these operations.

If the audit proposed in section 1 were to be confined to an audit of financial operations and legal compliance, some—but not all—of the Board's traditional objections would be removed. However, the Board is convinced that its present audit arrangements are more than adequate. A GAO audit limited to financial transactions and legal compliance would be a duplication of the audit now performed by an outside public accounting firm for the Board and by the Board itself for the Reserve banks.

In a sense, Congress has designated the Board of Governors as its "GAO" for purposes of reviewing the operations of the Reserve banks. The Board reports directly to Congress, and always stands ready to provide any information Congress seeks about expenditures by the System. If still another arm of Congress were directed to audit the Reserve banks, this would, at a minimum, diffuse audit responsibility, and have a low benefit yield in relationship to the cost.

In any event, there are some critical informational constraints that should be imposed. They include exemption of examination reports of member banks, certain transactions conducted with and on behalf of foreign central banks, and sensitive information about open market and discount operations. (Much of the information in the latter two categories becomes available with a lag.) A high degree of confidentiality in these areas is essential for the conduct of Federal Reserve functions; granting GAO access to these records could pose problems in assuring this confidentiality.

If the audit were to go beyond a basic financial audit, and GAO typically does in the course of its ordinary audit activities, the injection of management and policy critiques by GAO would be inconsistent with the long-established congressional policy that has insulated the Federal Reserve from such pressure. In the sensitive area of monetary policy, Congress has vested decisionmaking responsibility exclusively in the Federal Reserve, and has established safeguards to insure that the System will exercise professional—and entirely independent—judgment. We believe this arrangement should continue so long as it serves the longrun interest of the public.

Also, as in the case of the audit of financial transactions, the broader GAO audits would be duplicative of the kind of audit functions which I have just described. Reviews of management and operational efficiency are now an integral part of the System's audit activities, both at the Reserve banks and at the Board.

There is moreover the clear possibility, even probability, that an audit by GAO would in time generate pressures for the Federal Reserve System to dilute or compromise its best monetary or credit judgment to shortrun rather than longrun interests. The structure created by the framers of the Federal Reserve Act over 60 years ago, however unique and unconventional, has turned out to be remarkably adaptable to the U.S. economy and remarkably responsive to its longrun interests. This structure combines the advantages of regional units—the 12 Federal Reserve banks—with the central oversight and coordination of the Board.

Furthermore, it is obvious that the opponents of a monetary authority with the independence the Congress has long given the Federal Reserve would view this action as the opening wedge in a series of legislative measures by which they would hope to make monetary and credit policy responsive to shortrun political and economic pressures. They would ask Congress to take further steps to place the Board either directly under an executive branch agency or perhaps under day-to-day congressional control, however that might be accomplished. But Congress has, in our view, wisely avoided this possible line of development by continuing to place responsibility for internal management on the Board itself.

The unique character of the System, as conceived by the Congress, lies in the engagement of both the public and private sector, in all its regional variety, in the effort to serve the diverse economic interest of production, trade, agriculture, finance, and consumption. The Federal Reserve uses its regional links with the various sectors of the economy as channels for activation and response to monetary and credit measures. The arrangement has evolved into a sensing device of considerable value.

The System's blending of public and private elements, and its balance between central oversight and regional initiative, could be endangered if audits were to be conducted by GAO. This is not said in a spirit of criticism of the staff of GAO, but rather as a reflection of our concern for the institutional diversity of the Federal Reserve. Where differences were encountered between the way the Reserve banks function and prevailing Federal Government practice, the Government auditors might well support the latter, whether or not the end result would prove superior. For our part, it would be difficult for

the System to resist over the years a constant pressure to conform. A gradual process of erosion could begin which might well spell the end of the Reserve banks as we know them today. We have serious doubts, moreover, whether the final outcome of such a process would yield public benefits that could match those flowing from the present structure.

With regard to section 2, we support the amendment to section 14(b) of the Federal Reserve Act extending the authority of the Federal Reserve banks to purchase U.S. obligations directly from the Treasury. Timely use of this authority—for example, during periods immediately preceding taxpayment dates—can avoid the creation of unnecessary financial strains that might occur if the Treasury were required to draw heavily on its accounts at such times. There is no doubt the existence of the authority permits more economical cash management, and it also assures the immediate availability of funds in the event of a national emergency.

Section 3 of H.R. 10265 would raise by \$60 million the ceiling on expenditures which the Federal Reserve System may undertake for the construction and renovation of Reserve bank branch buildings. This is the dollar figure contained in a bill which the Senate passed in February 1972. In February of this year, Chairman Burns wrote to the distinguished chairman of this committee outlining a program of branch building expenditures totaling \$71.45 million as the Board's best estimate of its most pressing need sthrough 1977. This would include funds for construction of new branch buildings in Baltimore, Charlotte, Omaha, and Los Angeles.

Construction of these buildings is urgently needed. As our population grows and moves, it is necessary to increase the quantity of our services. While technological improvements in the method of handling many Federal Reserve operations have helped to stem the need for additional space, increases in the volume of operations have more than offset the savings. In the decade 1963-72, checks collected by the Federal Reserve increased 117 percent, coin operations increased 93 percent, and currency operations 56 percent. Construction of the branch buildings we are planning will help the System to continue to cope with the needs of the public in our expanding economy. As of today, due to cost increases, the construction program we outlined to Chairman Patman in February will cost \$76.2 million. We recommend that the dollar limitation in section 10 be increased by that amount.

Mr. MITCHELL. That is the end of my statement.

[The list of publications of the Federal Reserve Board referred to by Governor Mitchell in his statement follows:]

FEDERAL RESERVE BOARD PUBLICATIONS

Available from Publications Services, Division of Administrative Services, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. Where a charge is indicated, remittance should accompany request and be made payable to the order of the Board of Governors of the Federal Reserve System in a form collectible at par in U.S. currency. (Stamps and coupons are not accepted.)

ANNUAL REPORT

FEDERAL RESERVE BULLETIN. Monthly. \$6.00 per annum or \$.60 a copy in the United States and its possessions, Bolivia, Canada, Chile, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, Guatemala, Haiti, Republic of Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, El Salvador, Uruguay, and Venezuela; 10 or more of same issue sent to one address, \$5.00 per annum or \$.50 each. Elsewhere, \$7.00 per annum or \$.70 a copy.

FEDERAL RESERVE CHART BOOK ON FINANCIAL AND BUSINESS STATISTICS. Monthly. Annual subscription includes one issue of Historical Chart Book. \$6.00 per annum or \$.60 a copy in the United States and the countries listed above; 10 or more of same issue sent to one address, \$.50 each. Elsewhere, \$7.00 per annum or \$.70 a copy.

HISTORICAL CHART BOOK. Issued annually in Sept. Subscription to monthly chart book includes one issue. \$.60 a copy in the United States and countries listed above; 10 or more sent to one address, \$.50 each. Elsewhere, \$.70 a copy.

THE FEDERAL RESERVE ACT, as amended through December 1971, with an appendix containing provisions of certain other statutes affecting the Federal Reserve System. 252 pp. \$1.25.

REGULATIONS OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

PUBLISHED INTERPRETATIONS OF THE BOARD OF GOVERNORS, as of December 31, 1972. \$2.50.

FLOW OF FUNDS IN THE UNITED STATES, 1939-53. 1955. 390 pp.. \$2.75.

DEBITS AND CLEARING STATISTICS AND THEIR USE. 1959. 144 pp. \$1.00 a copy; 10 or more sent to one address, \$.85 each.

SUPPLEMENT TO BANKING AND MONETARY STATISTICS. **Sec. 1.** Banks and the Monetary System. 1962. 35 pp. \$.35. **Sec. 2.** Member Banks. 1967. 59 pp. \$.50. **Sec. 5.** Bank Debits. 1966. 36 pp. \$.35. **Sec. 6.** Bank Income. 1966. 29 pp. \$.35. **Sec. 9.** Federal Reserve Banks. 1965.

36 pp. \$.35. **Sec. 10.** Member Bank Reserves and Related Items. 1962. 64 pp. \$.50. **Sec. 11.** Currency. 1963. 11 pp. \$.35. **Sec. 12.** Money Rates and Securities Markets. 1966. 182 pp. \$.65. **Sec. 14.** Gold. 1962. 24 pp. \$.35. **Sec. 15.** International Finance. 1962. 92 pp. \$.65. **Sec. 16 (New).** Consumer Credit. 1965. 103 pp. \$.65.

INDUSTRIAL PRODUCTION—1971 edition. 383 pp. \$4.00 a copy; 10 or more sent to one address, \$3.50 each.

BANK MERGERS & THE REGULATORY AGENCIES: APPLICATION OF THE BANK MERGER ACT OF 1960. 1964. 260 pp. \$1.00 a copy; 10 or more sent to one address, \$.85 each.

BANKING MARKET STRUCTURE & PERFORMANCE IN METROPOLITAN AREAS: A STATISTICAL STUDY OF FACTORS AFFECTING RATES ON BANK LOANS. 1965. 73 pp. \$.50 a copy; 10 or more sent to one address, \$.40 each.

THE PERFORMANCE OF BANK HOLDING COMPANIES. 1967. 29 pp. \$.25 a copy; 10 or more sent to one address, \$.20 each.

THE FEDERAL FUNDS MARKET. 1959. 111 pp. \$1.00 a copy; 10 or more sent to one address, \$.85 each.

TRADING IN FEDERAL FUNDS. 1965. 116 pp. \$1.00 a copy; 10 or more sent to one address, \$.85 each.

U.S. TREASURY ADVANCE REFUNDING, JUNE 1960—JULY 1964. 1966. 65 pp. \$.50 a copy; 10 or more sent to one address, \$.40 each.

BANK CREDIT-CARD AND CHECK-CREDIT PLANS. 1968. 102 pp. \$1.00 a copy; 10 or more sent to one address, \$.85 each.

INTEREST RATE EXPECTATIONS: TESTS ON YIELD SPREADS AMONG SHORT-TERM GOVERNMENT SECURITIES. 1968. 83 pp. \$.50 a copy; 10 or more sent to one address, \$.40 each.

SURVEY OF FINANCIAL CHARACTERISTICS OF CONSUMERS. 1966. 166 pp. \$1.00 a copy; 10 or more sent to one address, \$.85 each.

JUNE 1973

SURVEY OF CHANGES IN FAMILY FINANCES. 1968. 321 pp. \$1.00 a copy; 10 or more sent to one address, \$.85 each.

REPORT OF THE JOINT TREASURY-FEDERAL RESERVE STUDY OF THE U.S. GOVERNMENT SECURITIES MARKET. 1969. 48 pp. \$.25 a copy; 10 or more sent to one address, \$.20.

(Limited supplies, in mimeographed or similar form, of staff papers listed on p. 48 of report above (other than those contained in Parts 1 and 2) are available upon request for single copies.)

JOINT TREASURY-FEDERAL RESERVE STUDY OF THE GOVERNMENT SECURITIES MARKET: STAFF STUDIES—PART 1 (papers by Cooper, Bernard, and Scherer). 1970. 86 pp. \$.50 a copy; 10 or more sent to one address, \$.40 each. PART 2 (papers by Ettin, Peskin, and Ahearn and Peskin). 1971. 153 pp. \$1.00 a copy; 10 or more sent to one address, \$.85 each.

OPEN MARKET POLICIES AND OPERATING PROCEDURES—STAFF STUDIES (papers by Axilrod, Davis, Andersen, Kareken *et al.*, Pierce, Friedman, and Poole). 1971. 218 pp. \$2.00 a copy; 10 or more sent to one address, \$1.75 each.

REAPPRAISAL OF THE FEDERAL RESERVE DISCOUNT MECHANISM, Vol. 1 (papers by Steering Committee, Shull, Anderson, and Garvy). 1971. 276 pp. Vol. 2 (papers by Boulding, Chandler, Jones, Ormsby, Modigliani, Alperstein, Melichar, and Melichar and Doll). 1971. 173 pp. Vol. 3 (papers by Staats, Willis, Minsky, Stackhouse, Meek, Holland and Garvy, and Lynn). 1972. 220 pp. Each volume \$3.00 a copy; 10 or more sent to one address, \$2.50 each.

THE ECONOMETRICS OF PRICE DETERMINATION CONFERENCE, October 30-31, 1970, Washington, D.C. Oct. 1972, 397 pp. Cloth ed. \$5.00 a copy; 10 or more sent to one address, \$4.50 each. Paper ed. \$4.00 a copy; 10 or more sent to one address, \$3.60 each.

FEDERAL RESERVE STAFF STUDY: WAYS TO MODERATE FLUCTUATIONS IN HOUSING CONSTRUCTION, Dec. 1972, 487 pp. \$4.00 a copy; 10 or more sent to one address, \$3.60 each.

STAFF ECONOMIC STUDIES

Studies and papers on economic and financial subjects that are of general interest in the field of economic research.

Summaries only printed in the BULLETIN.

(Limited supply of mimeographed copies of full text available upon request for single copies)

CREDIT RATIONING: A REVIEW, by Benjamin M. Friedman. June 1972. 26 pp.

REGULATION Q AND THE COMMERCIAL LOAN MARKET IN THE 1960's, by Benjamin M. Friedman. June 1972. 38 pp.

THE REGULATION OF SHORT-TERM CAPITAL MOVEMENTS IN MAJOR COUNTRIES, by Rodney H. Mills, Jr. Nov. 1972. 53 pp.

FEDERAL RESERVE DEFENSIVE BEHAVIOR AND THE REVERSE CAUSATION ARGUMENT, by Raymond Lombra and Raymond Torto. Nov. 1972. 15 pp.

EXAMINATION OF THE MONEY STOCK CONTROL APPROACH OF BURGER, KALISH, AND BABB, by Fred J. Levin. March 1973.

OBTAINING THE YIELD ON A STANDARD BOND FROM A SAMPLE OF BONDS WITH HETEROGENEOUS CHARACTERISTICS, by James L. Kichline, P. Michael Laub, and Guy V. G. Stevens. May 1973. 30 pp.

THE DETERMINANTS OF A DIRECT INVESTMENT OUTFLOW WITH EMPHASIS ON THE SUPPLY OF FUNDS, by Frederic Brill Ruckdeschel. June 1973. 171 pp.

Printed in full in the BULLETIN.

(Staff Economic Studies are included in list of reprints below.)

REPRINTS

ADJUSTMENT FOR SEASONAL VARIATION. June 1941. 11 pp.

SEASONAL FACTORS AFFECTING BANK RESERVES. Feb. 1958. 12 pp.

LIQUIDITY AND PUBLIC POLICY, **Staff Paper** by Stephen H. Axilrod. Oct. 1961. 17 pp.

SEASONALLY ADJUSTED SERIES FOR BANK CREDIT. July 1962. 6 pp.

INTEREST RATES AND MONETARY POLICY, **Staff Paper** by Stephen Axilrod. Sept. 1962. 28 pp.

MEASURES OF MEMBER BANK RESERVES. July 1963. 14 pp.

REVISION OF BANK DEBITS AND DEPOSIT TURN-OVER SERIES. Mar. 1965. 4 pp.

- RESEARCH ON BANKING STRUCTURE AND PERFORMANCE, **Staff Economic Study** by Tynan Smith. Apr. 1966. 11 pp.
- A REVISED INDEX OF MANUFACTURING CAPACITY, **Staff Economic Study** by Frank de Leeuw with Frank E. Hopkins and Michael D. Sherman. Nov. 1966. 11 pp.
- REVISED SERIES ON COMMERCIAL AND INDUSTRIAL LOANS BY INDUSTRY. Feb. 1967. 2 pp.
- THE PUBLIC INFORMATION ACT—ITS EFFECT ON MEMBER BANKS. July 1967. 6 pp.
- INTEREST COST EFFECTS OF COMMERCIAL BANK UNDERWRITING OF MUNICIPAL REVENUE BONDS. Aug. 1967. 16 pp.
- U.S. INTERNATIONAL TRANSACTIONS: TRENDS IN 1960-67. Apr. 1968. 23 pp.
- FEDERAL FISCAL POLICY IN THE 1960's. Sept. 1968. 18 pp.
- BUSINESS FINANCING BY BUSINESS FINANCE COMPANIES. Oct. 1968. 13 pp.
- HOUSING PRODUCTION AND FINANCE. Mar. 1969. 7 pp.
- THE CHANNELS OF MONETARY POLICY, **Staff Economic Study** by Frank de Leeuw and Edward Gramlich. June 1969. 20 pp.
- REVISION OF WEEKLY SERIES FOR COMMERCIAL BANKS. Aug. 1969. 5 pp.
- EURO-DOLLARS: A CHANGING MARKET. Oct. 1969. 20 pp.
- RECENT CHANGES IN STRUCTURE OF COMMERCIAL BANKING. Mar. 1970. 16 pp.
- SDR's IN FEDERAL RESERVE OPERATIONS AND STATISTICS. May 1970. 4 pp.
- MEASURES OF SECURITY CREDIT. Dec. 1970. 11 pp.
- MONETARY AGGREGATES AND MONEY MARKET CONDITIONS IN OPEN MARKET POLICY. Feb. 1971. 26 pp.
- BANK FINANCING OF MOBILE HOMES. Mar. 1971. 4 pp.
- INTEREST RATES, CREDIT FLOWS, AND MONETARY AGGREGATES SINCE 1964. June 1971. 16 pp.
- TWO KEY ISSUES OF MONETARY POLICY. June 1971. 4 pp.
- SURVEY OF DEMAND DEPOSIT OWNERSHIP. June 1971. 12 pp.
- BANK RATES ON BUSINESS LOANS—REVISED SERIES. June 1971. 10 pp.
- INDUSTRIAL PRODUCTION—REVISED AND NEW MEASURES. July 1971. 26 pp.
- REVISED MEASURES OF MANUFACTURING CAPACITY UTILIZATION. Oct. 1971. 3 pp.
- REVISION OF BANK CREDIT SERIES. Dec. 1971. 5 pp.
- PLANNED AND ACTUAL LONG-TERM BORROWING BY STATE & LOCAL GOVERNMENTS. Dec. 1971. 11 pp.
- ASSETS AND LIABILITIES OF FOREIGN BRANCHES OF U.S. BANKS. Feb. 1972. 16 pp.
- WAYS TO MODERATE FLUCTUATIONS IN THE CONSTRUCTION OF HOUSING. Mar. 1972. 11 pp.
- CHANGES IN BANK LENDING PRACTICES, 1971. Apr. 1972. 5 pp.
- CONSTRUCTION LOANS AT COMMERCIAL BANKS. June 1972. 12 pp.
- SOME ESSENTIALS OF INTERNATIONAL MONETARY REFORM. June 1972. 5 pp.
- CHARACTERISTICS OF FEDERAL RESERVE BANK DIRECTORS. June 1972. 10 pp.
- BANK DEBITS, DEPOSITS, AND DEPOSIT TURN-OVER—REVISED SERIES. July 1972. 5 pp.
- RECENT REGULATORY CHANGES IN RESERVE REQUIREMENTS AND CHECK COLLECTION. July 1972. 5 pp.
- BANKING AND MONETARY STATISTICS, 1971. Selected series of banking and monetary statistics for 1971 only. Feb., Mar., and July 1972. 20 pp.
- YIELDS ON NEWLY ISSUED CORPORATE BONDS. Sept. 1972. 2 pp.
- RECENT ACTIVITIES OF FOREIGN BRANCHES OF U.S. BANKS. Oct. 1972. 11 pp.
- REVISION OF CONSUMER CREDIT STATISTICS. Oct. 1972. 21 pp.
- SURVEY OF FINANCE COMPANIES, 1970. Nov. 1972. 15 pp.
- ONE-BANK HOLDING COMPANIES BEFORE THE 1970 AMENDMENTS. Dec. 1972. 13 pp.
- EVOLUTION OF THE PAYMENTS MECHANISM. Dec. 1972. 4 pp.
- REVISION OF THE MONEY STOCK MEASURES AND MEMBER BANK RESERVES AND DEPOSITS. Feb. 1973. 19 pp.

TREASURY AND FEDERAL RESERVE FOREIGN EXCHANGE OPERATIONS. Mar. 1973. 22 pp.	FINANCIAL DEVELOPMENTS IN THE FIRST QUARTER OF 1973. May 1973. 10 pp.
DEVELOPMENTS IN U.S. BALANCE OF PAYMENTS. Apr. 1973. 13 pp.	YIELDS ON RECENTLY OFFERED CORPORATE BONDS. May 1973. 2 pp.
CHANGES IN TIME AND SAVINGS DEPOSITS AT COMMERCIAL BANKS, JULY 1972-JAN. 1973. Apr. 1973. 15 pp.	FEDERAL FISCAL POLICY, 1965-72. June 1973. 20 pp.
STATE AND LOCAL BORROWING ANTICIPATIONS AND REALIZATIONS. Apr. 1973. 4 pp.	SOME PROBLEMS OF CENTRAL BANKING. June 1973. 3 pp.
	OPEN MARKET OPERATIONS IN 1972. June 1973. 12 pp.

**ANTICIPATED SCHEDULE OF RELEASE DATES FOR PUBLIC PERIODIC RELEASES¹—
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

Weekly releases	Approximate release day	Date or period to which data refer
Aggregate Reserves and Member Bank Deposits (H.3)	Tuesday	Week ended previous Wednesday
Applications and Reports Received, or Acted on, by the Board (H.2)	Friday	Week ended previous Saturday
Assets and Liabilities of All Commercial Banks in the United States (H.8)	Wednesday	Wednesday, 2 weeks earlier
Capital Market Developments (H.16)	Monday	Week ended previous Friday
Changes in State Member Banks (K.3)	Tuesday	Week ended previous Saturday
Commercial and Industrial Loans Outstanding by Industry (H.12) ²	Wednesday	Wednesday, 1 week earlier
Condition Report of Large Commercial Banks in New York and Chicago (H.4.3)	Thursday	Previous Wednesday
Condition Report of Large Commercial Banks and Domestic Subsidiaries (H.4.2) ³	Wednesday	Wednesday, 1 week earlier
Deposits, Reserves, and Borrowings of Member Banks (H.7)	Wednesday	Week ended 3 Wednesdays earlier
Factors Affecting Bank Reserves and Condition Statement of Federal Reserve Banks (H.4.1)	Thursday	Week ended previous Wednesday
Money Stock Measures (H.6)	Thursday	Week ended Wednesday of previous week
Reserve Positions of Major Reserve City Banks (H.5)	Friday	Week ended Wednesday of previous week

Weekly releases (cont.)	Approximate release day	Date or period to which data refer
Selected Interest and Exchange Rates for Major Countries and the United States (H.13)	Thursday	Week ended previous Saturday
Weekly Foreign Exchange Rates (H.10)	Monday	Week ended previous Friday
Weekly Summary of Banking and Credit Measures (H.9)	Thursday	Week ended previous Wednesday; and week ended Wednesday of previous week
Weekly U.S. Government Security Yields and Prices (H.15)	Monday	Week ended previous Saturday
Semimonthly and bimonthly releases		
Finance Rates and Other Terms on Selected Categories of Consumer Instalment Credit Extended by Finance Companies (J.3)	20th of month	2nd month previous
Research Library—Recent Acquisitions (J.2)	1st and 16th of month	Period since last release
Monthly releases		
Assets and Liabilities of All Member Banks by Districts (G.7.1)	14th of month	Last Wednesday of previous month
Automobile Loans by Major Finance Companies (G.25)	7th working day of month	2nd month previous
Automobile Instalment Credit Developments (G.26)	6th working day of month	2nd month previous
Bank Debits, Deposits, and Deposit Turnover (G.6)	25th of month	Previous month
Commercial and Industrial Term Loans Outstanding by Industry (H.12b) Available only as attachment to weekly H.12 release	2nd Wednesday of month	Last Wednesday of previous month
Consumer Credit (G.19)	3rd working day of month	2nd month previous
Consumer Instalment Credit at Commercial Banks (G.18)	4th working day of month	2nd month previous
Finance Companies (G.20)	5th working day of month	2nd month previous
Finance Rate and Other Terms on New and Used Car Instalment Credit Contracts Purchased from Dealers by Major Auto Finance Companies (G.11)	30th of month	Previous month
Index Numbers of Wholesale Prices (G.8)	20th of month	Previous month
Industrial Production (G.12.2)	15th of month	Previous month
Industrial Production and Related Data (G.12.3) (Similar data also available annually. see p. A-116)	15th of month	Previous month
Interdistrict Settlement Fund (G.15)	15th of month	Previous month
Interest Rates Charged on Selected Types of Bank Loans (G.10)	15th of month	2nd month previous

Monthly releases (cont.)	Approximate release day	Date or period to which data refer
Maturity Distribution of Euro-Dollar Deposits in Foreign Branches of U.S. Banks (G.17)	1st of month	Last day of 3rd month previous
Maturity Distribution of Outstanding Negotiable Time Certificates of Deposits (G.9)	24th of month	Last Wednesday of previous month
Monthly Foreign Exchange Rates (G.5)	1st of month	Previous month
Open Market Money Rates and Bond Prices (G.13)	6th of month	Previous month
State Member Banks of Federal Reserve System and Non-member Banks that Maintain Clearing Accounts with Federal Reserve Banks (G.4)	1st week of month	Previous month
(Also annual)	1st week of February	End of previous year
Summary of Equity Security Transactions (G.16)	Last week of month	Release date
U.S. Government Security Yields and Prices (G.14)	4th of month	Previous month

Quarterly releases

Bank Rates on Short Term Business Loans (E.2)	18th of March, June, September, December	1st 15 days of February, May, August, November
Capacity Utilization in Manufacturing (E.5)	21st of January, April, July, October	Previous quarter
Flow of Funds: Seasonally adjusted and unadjusted (Z.1) Seasonally adjusted only (Z.1a)	15th of February, May, August, and November	Previous quarter
Volume and Composition of Individuals' Saving (Flow of funds series) (E.8)		
Sales, Profits, and Dividends of Large Corporations (E.6) ⁴	10th of April, June, September, December	2nd quarter previous

Semiannual releases

Assets and Liabilities of All Commercial Banks, by Class of Bank (E.3.4)	May and November	End of previous December and June
List of OTC Margin Stocks (E.7)	June 30, December 31	Release date
Assets, Liabilities, and Capital Accounts of Commercial and Mutual Savings Banks—Reports of Call (Joint Release of Federal Deposit Insurance Corp., Board of Governors of Federal Reserve System, and Office of Comptroller of the Currency. <i>Published and distributed by FDIC.</i>)	May and November	End of previous December and June

Annual releases	Approximate release day	Date or period to which data refer
Bank Debits to Demand Deposit Accounts Except Interbank and U.S. Government Accounts (C.5)	March 25	Previous year
End of Month Demand Deposits Except Interbank and U.S. Government Accounts (C.5a)	March 25	Previous year
Federal Reserve Par List (G.3)	Early November	Previous September 30
(Also monthly supplements)	5th of month	Period since last release
Industrial Production and Related Data (Available upon request, after being announced)	November	Previous year
Member Bank Income (C.4)	End of May	Previous year

¹Release dates are those anticipated or usually met. However, it should be noted that for some releases there is normally a certain variability because of reporting or processing procedures. Moreover, for all series unusual circumstances may, from time to time, result in a release date being later than anticipated.

²Contains monthly H.12b release on second Wednesday of month.

³Contains revised H.4.3 data.

⁴Publication temporarily suspended.

The CHAIRMAN. Thank you very much, Governor Mitchell.

I heard through Federal Reserve people that the Federal Reserve set up a network of regional check processing centers to computerize and speed up the payment mechanism. I have heard that it will cost as much as \$500 million annually to run this system when it is fully operational.

Is that information substantially correct, Mr. Mitchell?

Mr. MITCHELL. What was that figure you mentioned?

The CHAIRMAN. \$500 million annually.

Mr. MITCHELL. No. For many, many years we had 36 offices, and we now have operational 43 offices. And we may add two or three more in order to improve the service that we are rendering; and the cost of the additional offices would be of the order of \$20 million, I think.

The CHAIRMAN. In other words, that is incorrect, is that right?

Mr. MITCHELL. Yes, it is incorrect by a substantial amount, Mr. Chairman.

The CHAIRMAN. Well, how much is it then approximately?

Mr. MITCHELL. I would say approximately \$20 to \$25 million.

The CHAIRMAN. And not \$500 million?

Mr. MITCHELL. Absolutely not. Our total expenditures are now \$400 million for the whole system.

The CHAIRMAN. You stated a while ago that you had always responded promptly to congressional inquiries. I have not had that experience all the way through. Generally I get replies fairly reasonably soon, but in some cases we have not.

For instance, in 1959 when we were considering a bill that if it passed, it would give the Federal Reserve the power to keep about \$10 billion of the portfolio; but the remainder of about \$15 billion, you wanted the privilege to let the commercial banks have it, member banks, on the theory that they needed the money, the income from the bonds, and the Federal Reserve did not need the income from the bonds.

And in that colloquy with Mr. Martin I asked for specific information. I outlined the questions to him personally. And do you know, it was 6 months before we got a reply to that.

Now, that is one of the worst cases I think that I have had, but I have had some that were not as bad but were disturbing at least. And recently I have written to the Chairman of the Federal Reserve Board, asking him the salaries of all people—about 20,000 employees, I believe you have—that had salaries of \$20,000 or more. And I wanted a comparison of 3 years ago and now as to what the salaries were.

And I received what I considered to be almost a runaround on it. The reply was by numbers, one employee getting so much salary, not even mentioning his name or anything else. Several pages like that—absolutely meaningless.

I cannot understand why the Fed would make such a reply as that. I would not say it was trifling with the committee, but it was not far from it.

Mr. MITCHELL. Were you interested in the names of the people or the positions?

The CHAIRMAN. I specifically asked for names in the letters, and that has been weeks ago, months ago; and I have just received them in the last few days. Just these numbers; no names. And so, I would

really like to have a better reply to that, Governor Mitchell. Can you help me on it?

Mr. MITCHELL. Well, Mr. Chairman, I am not advised as to what our situation is with respect to that response. But I would only say that the information is available.

The CHAIRMAN. Well, it is available, of course. I could not conceive of the Federal Reserve not having it available.

Mr. MITCHELL. Yes. That is correct.

The CHAIRMAN. You could not conceive of it not being available.

Mr. MITCHELL. Well, the only thing that troubles me about the request is the names of the people. Now, you know the names of the presidents and their salaries are made public.

The CHAIRMAN. Well, anyway we will let that go if you state that you are not in a position to answer the question.

Now then, let's discuss taxes. Of course, the Federal Reserve is exempt from taxation, but how do you—suppose a bond comes due in your portfolio. Do you collect that money at the time it matures and the money is due by the Treasury?

Do you collect it?

Mr. MITCHELL. Most of the bonds that we hold from the Treasury are exchanged for another issue.

The CHAIRMAN. Are exchanged, in other words rolled over.

Mr. MITCHELL. Yes, sir.

The CHAIRMAN. Well, do you not have some earnings like that where they are paid in cash?

Mr. MITCHELL. We sell securities sometimes at a profit.

The CHAIRMAN. Where do you put that money?

Mr. MITCHELL. It goes into our earnings.

The CHAIRMAN. It goes into your earnings? In your report do you enumerate the earnings, itemize them?

Mr. MITCHELL. Just from the capital gains from the change in the value of the security. Mr. Chairman, I am sure that we have the information, but I do not know that it is published in our annual report.

The CHAIRMAN. Anyway, if we wanted it, you could get it?

Mr. MITCHELL. Yes.

The CHAIRMAN. Do you pay any taxes at all now?

Mr. MITCHELL. We pay State and local taxes on all of our real estate.

The CHAIRMAN. That is all?

Mr. MITCHELL. Yes.

The CHAIRMAN. But you have lots of transactions in a year?

Mr. MITCHELL. The Federal Reserve banks pay State and local taxes.

The CHAIRMAN. The Open Market Committee had transactions last year, I believe it was, of \$738 billion. In other words, it was between \$2 and \$3 billion a day. Somebody made some money on that.

Mr. MITCHELL. You have been misinformed on that, I believe Mr. Chairman.

The CHAIRMAN. I beg your pardon?

Mr. MITCHELL. I think you have been misinformed on that.

The CHAIRMAN. I did not understand you, Governor.

Mr. MITCHELL. I think you have been misinformed on that number.

The CHAIRMAN. Well, we have had an investigation. I asked Mr. Staats to investigate it—I believe it was in 1970 or 1971—and he came back with a report, and it was \$738 billion in transactions in a year.

No one can dispute that. It is recorded and itemized, documented, everything.

Now, that is just part of the Federal Reserve. I would estimate the Federal Reserve had at least a trillion dollars in transactions during that year.

Mr. MITCHELL. Well, let me start from this proposition, Mr. Chairman. Our portfolio is \$75 billion. That is what we own in Government securities.

The CHAIRMAN. That is now?

Mr. MITCHELL. That is what it is about right now.

The CHAIRMAN. Yes. I think this would be a good place to put into the record the size of your portfolio since 1914, the first year. It was just about a few million dollars at that time.

And without objection, I will place in the record the amount each year since that time in your portfolio in, incidentally, the Federal Reserve Bank of New York.

[The information referred to by Chairman Patman follows:]

*Federal Reserve portfolio holdings of U.S. Government securities, Dec. 31, 1914—
July 31, 1973*

	<i>Amount</i>
1914.....	\$16, 000, 000
1915.....	55, 000, 000
1916.....	122, 000, 000
1917.....	239, 000, 000
1918.....	300, 000, 000
1919.....	287, 000, 000
1920.....	234, 000, 000
1921.....	436, 000, 000
1922.....	134, 000, 000
1923.....	540, 000, 000
1924.....	375, 000, 000
1925.....	315, 000, 000
1926.....	617, 000, 000
1927.....	228, 000, 000
1928.....	511, 000, 000
1929.....	729, 000, 000
1930.....	817, 000, 000
1931.....	1, 855, 000, 000
1932.....	2, 437, 000, 000
1933.....	2, 430, 000, 000
1934.....	2, 431, 000, 000
1935.....	2, 430, 000, 000
1936.....	2, 564, 000, 000
1937.....	2, 564, 000, 000
1938.....	2, 510, 000, 000
1939.....	2, 188, 000, 000
1940.....	2, 219, 000, 000
1941.....	5, 549, 000, 000
1942.....	11, 166, 000, 000
1943.....	18, 693, 000, 000
1944.....	23, 708, 000, 000
1945.....	23, 767, 000, 000
1946.....	21, 905, 000, 000
1947.....	23, 002, 000, 000
1948.....	18, 287, 000, 000
1949.....	20, 345, 000, 000
1950.....	23, 409, 000, 000
1951.....	24, 400, 000, 000
1952.....	25, 639, 000, 000
1953.....	24, 917, 000, 000
1954.....	24, 917, 000, 000

Federal Reserve portfolio holdings of U.S. Government securities, Dec. 31, 1914—
July 31, 1973—Continued

	Amount
1955	\$24,602,000,000
1956	24,765,000,000
1957	23,982,000,000
1958	26,312,000,000
1959	27,036,000,000
1960	27,248,000,000
1961	29,098,000,000
1962	30,546,000,000
1963	33,729,000,000
1964	37,126,000,000
1965	40,885,000,000
1966	43,760,000,000
1967	48,891,000,000
1968	52,529,000,000
1969	57,500,000,000
1970	61,688,000,000
1971	69,158,000,000
1972	71,094,000,000
1973 (July 31)	76,133,000,000

Source: 1914-38, Historical Statistics of the United States, U.S. Department of Commerce, Bureau of Census; 1939-72, Economic Report of the President, January 1973; Federal Reserve Bulletin, August 1973.

[In response to the request of Mr. Brown on page 121, the comparable budget information of the Federal Government for the years 1914-73 follows:]

BUDGET RECEIPTS AND OUTLAYS, 1914-73

[In millions of dollars]

Fiscal year	Receipts	Outlays	Surplus or deficit	Fiscal year	Receipts	Outlays	Surplus or deficit
Administrative budget:				Consolidated cash statement—Continued			
1914	725	726	(1)	1944	47,818	93,956	-46,138
1915	683	746	-63	1945	50,162	95,184	-45,022
1916	761	713	+48	1946	43,537	61,738	-18,210
1917	1,101	1,954	-853	1947	43,431	36,931	+6,600
1918	3,645	12,677	-9,032	1948	45,357	36,493	+8,864
1919	5,130	18,493	-13,363	1949	41,576	40,570	+1,006
1920	6,649	6,358	+291	1950	40,940	43,147	-2,207
1921	5,571	5,062	+509	1951	53,390	45,797	+7,593
1922	4,026	3,289	+736	1952	58,011	67,962	-9,951
1923	3,853	3,140	+713	1953	71,495	76,769	-5,274
1924	3,871	2,908	+963	Unified budget:			
1925	3,641	2,924	+717	1954	69,719	70,890	-1,170
1926	3,795	2,830	+965	1955	65,469	68,509	-3,040
1927	4,013	2,857	+1,155	1956	74,547	70,460	+4,087
1928	3,900	2,961	+939	1957	79,990	76,741	+3,249
1929	3,862	3,127	+734	1958	79,636	82,575	-2,939
1930	4,058	3,320	+738	1959	79,249	92,104	-12,855
1931	3,116	3,577	-462	1960	92,492	92,223	+269
1932	1,924	4,659	-2,735	1961	94,389	97,795	-3,406
1933	1,997	4,598	-2,602	1962	99,676	106,813	-7,137
1934	3,015	6,645	-3,630	1963	106,560	111,311	-4,751
1935	3,706	6,497	-2,791	1964	112,662	118,584	-5,922
1936	3,997	8,422	-4,425	1965	116,833	118,430	-1,596
1937	4,956	7,733	-2,777	1966	130,856	134,652	-3,796
1938	5,588	6,765	-1,177	1967	149,552	158,254	-8,702
1939	4,979	8,841	-3,862	1968	153,671	178,833	-25,161
Consolidated cash statement:				1969	187,784	184,548	+3,236
1940	6,879	9,589	-2,710	1970	193,743	196,588	-2,845
1941	9,202	13,980	-4,778	1971	188,392	211,425	-23,033
1942	15,104	34,500	-19,396	1972	208,649	231,876	-23,227
1943	25,097	78,909	-53,812	1973 estimate	224,984	249,796	-24,812

¹ Less than \$500,000.

Notes. Certain interfund transactions are excluded from receipts and outlays starting in 1932. For years prior to 1932 the amounts of such transactions are not significant.

Refunds of receipts are excluded from receipts and outlays starting in 1913; comparable data are not available for prior years.

The CHAIRMAN. I wonder how much in securities you have in the Federal Reserve Bank in New York in addition to this \$76,133 million that you had there on July 31 of this year.

Do you have gold in the Federal Reserve Bank in New York?

Mr. MITCHELL. Yes, we have gold that belongs to foreigners.

The CHAIRMAN. Do you have an itemized statement of that?

Mr. MITCHELL. Yes, we do.

The CHAIRMAN. Would you put it in the record at this point?

Mr. MITCHELL. I do not see any reason for not doing it, so—

The CHAIRMAN. And you would be glad to do that?

Mr. MITCHELL. Yes.

The CHAIRMAN. That will be fine. Anything—securities, cash, gold, or metals.

[The following information was supplied by Governor Mitchell for the record:]

In addition to the assets shown on the H.4.1(b) release of October 3, the Federal Reserve Bank of New York holds assets in custody for foreign official and international accounts. The assets it holds in such custody are: \$15.5 billion in earmarked gold and \$55.9 billion in U.S. Treasury securities (as of the end of August). In addition, at the end of August the New York Reserve Bank had custody of foreign deposits of \$259 million.

STATEMENT OF CONDITION OF EACH FEDERAL RESERVE BANK ON OCT. 3, 1973

[In millions of dollars]

Assets	Total	Boston	New York	Phila- delphia	Cleve- land	Rich- mond	Atlanta	Chicago	St. Louis	Minne- apolis	Kansas City	Dallas	San Francisco
Gold certificate account	10,303	382	46	724	602	1,054	372	2,410	310	176	43	422	3,762
Special drawing rights certified account	400	23	93	23	33	36	72	70	15	7	15	14	49
Federal Reserve notes of other banks	1,230	173	307	32	50	102	172	61	29	29	38	78	159
Other cash	1,307	16	24	4	32	35	41	37	20	7	36	14	41
Loans	1,206	86	53	79	96	107	154	218	58	25	154	75	61
Acceptances:													
Bought outright	40		40										
Held under repurchase agreements	99		99										
Federal agency obligations—													
Bought outright	1,566	71	418	85	119	112	84	249	57	29	66	66	210
Held under repurchase agreements	356		356										
U.S. Government securities—													
Bought outright—													
Bills	34,289	1,558	9,159	1,871	2,603	2,447	1,845	5,442	1,243	645	1,448	1,440	4,588
Certificates:													
Other	37,374	1,699	9,963	2,038	2,838	2,668	2,010	5,932	1,354	703	1,578	1,569	5,002
Notes	3,428	1,156	916	187	260	245	184	544	124	64	145	144	459
Bonds													
Total bought outright	75,091	3,413	20,058	4,096	5,701	5,360	4,039	11,918	2,721	1,412	3,171	3,153	10,049
Held under repurchase agreements ¹	1,753		1,753										
Total U.S. Government securities	76,844	3,413	21,811	4,096	5,701	5,360	4,039	11,918	2,721	1,412	3,171	3,153	10,049
Total loans and securities	80,111	3,570	22,817	4,260	5,916	5,579	4,277	12,365	2,836	1,466	3,391	3,294	10,320
Cash items in process of collection	11,085	404	1,921	437	468	1,474	1,095	1,485	430	1,587	3,774	593	1,217
Bank premises	213	40	7	9	27	14	15	16	14	34	17	12	8
Other assets ²	815	34	214	41	55	96	42	113	26	18	31	31	114
Total assets	104,464	4,642	25,429	5,530	7,183	8,590	6,036	16,577	3,680	2,324	4,345	4,458	15,670

¹ Includes \$87,000,000 securities loaned—fully secured by U.S. Government securities pledged with Federal Reserve Banks. ² Includes assets denominated in foreign currencies.

The CHAIRMAN. Now, at one time I was up there, and there was about 200 or 300 people clipping coupons. And I was up there a few years later and went in the same room, the same three fellows had the key to the portfolio safe, One went up and unlocked his part, and the other one his part, and the other one his part, and opened the safe, and I did not see any bonds.

And he said reach up there and get one; there is a stack up there. So I reached up and got one and there was about \$1 billion, and the coupon, of course, is in proportion. And there was just a small stack of bonds

I presume that you still carry that policy of buying the bonds in small amounts and shipping them to the Treasury and having big bonds made, so as to eliminate the expense of coupon clipping.

Mr. MITCHELL. Yes. Mr. Chairman, I mentioned earlier the idea of using a book entry system. Our dealings now in Government securities largely are on a book entry basis, and there is no coupon clipping that is required.

The CHAIRMAN. They do not even have coupons?

Mr. MITCHELL. That is right.

Mr. BROWN. Mr. Chairman, are you going to put that list in the record?

The CHAIRMAN. Yes, sir.

Mr. BROWN. Well, reserving the right to object to its being admitted in the record, I would ask—and I will not object if the Chair will comply with my request—that the budget of the Federal Government for each of those years be provided right beside the figures you are presenting.

The CHAIRMAN. Well, mine is already—

Mr. BROWN. The staff can do that. All they have got to do is insert in the record the comparable figures of the budget for the same years; or else I will object to the admission of your entry.

The CHAIRMAN. Well, of course mine has already been passed on.

Mr. BROWN. No, Mr. Chairman. I was reserving the right to object.

The CHAIRMAN. Well, I do not want any squabble about it.

Mr. BROWN. I see no reason to squabble about it. I think you would agree that for comparison purposes budget information is relevant to the information on the portfolio of the Federal Reserve Board.

The CHAIRMAN. In consideration of the subject matter today I do not think it is as relevant.

Mr. BROWN. Then I do not think the information you are putting in the record is relevant either, so I will object to it.

The CHAIRMAN. Why do you not ask consent to put it in? I do not think there would be any objection to it. I just do not want to do it.

Mr. BROWN. No; I am not asking you to do it, Mr. Chairman. I am asking the staff to do it.

Is my request granted?

The CHAIRMAN. Make the request.

Mr. BROWN. I request that the comparable budget information for the Federal Government be put into the record along with the information with respect to the portfolio of the Federal Reserve Board that you have requested.

The CHAIRMAN. For each year?

Mr. BROWN. For each year.

The CHAIRMAN. Well, I think we could get that all right from two or three sources.

Mr. BROWN. If the chairman agrees to put that information in the record, I withdraw my objection.

The CHAIRMAN. I do not object to it. It is perfectly all right. I just did not want to ask it myself, because it confuses the issue a little bit on what I am dealing with right now.

[In response to the request of Mr. Brown, the comparable budget information of the Federal Government for the years 1914-73, may be found on page 118.]

The CHAIRMAN. Now, in keeping your money for the Federal Reserve, you keep it in the Federal Reserve banks, do you not?

Mr. MITCHELL. Yes, sir.

The CHAIRMAN. Do you have any money in private commercial banks?

Mr. MITCHELL. No, sir.

The CHAIRMAN. Do you have any in foreign countries?

Mr. MITCHELL. We own some foreign currencies.

The CHAIRMAN. I am talking about do you have money—

Mr. MITCHELL. We have deposits. On our balance sheet there is—

The CHAIRMAN. I know, but I am not asking you about that now. I am just asking you a direct question, a specific. Do you have any accounts in any outside banks in foreign countries?

Mr. MITCHELL. Public or private?

The CHAIRMAN. Both.

Mr. MITCHELL. Well, we have some in public banks.

The CHAIRMAN. Do you have it in private banks, too?

Mr. MITCHELL. No.

The CHAIRMAN. In which public banks do you have accounts?

Mr. MITCHELL. Other central banks.

The CHAIRMAN. And you can check on it if you want to?

Mr. MITCHELL. I do not understand.

The CHAIRMAN. If you need the money do you check on it like you do a commercial bank?

Mr. MITCHELL. It is in the form of a credit that is extended.

The CHAIRMAN. I do not really understand why you do not just be forthright and tell us about these accounts. You either have them or you do not have them.

Now, you state that you have them in some central banks, and of course, you would handle them just like you would a commercial bank, a checking account.

Are they considerable, or small, or medium sized?

Mr. MITCHELL. Well, that is what I was going to see. I think at the present time it is in the balance sheet. I was going to look it up. The total is something like \$4 million.

The CHAIRMAN. I do not want you to take too much time on that.

Mr. MITCHELL. Well, let me supply that for the record, would you, Mr. Chairman?

The CHAIRMAN. All right. You just put it in the record.

[The following information was supplied by Governor Mitchell for the record:]

As indicated in the table on page A11 of the September 1973 *Federal Reserve Bulletin*, there is \$4 million of convertible foreign currencies held by Federal Reserve Banks, principally Japanese yen and Swiss francs.

The CHAIRMAN. Now, you mentioned a while ago about \$17 trillion worth of transactions by wire. Was that last year or the last fiscal year.

Mr. MITCHELL. That was calendar 1972.

The CHAIRMAN. Well, that is in addition to the transactions by the 20 dealers?

Mr. MITCHELL. No. These are transactions that use our wire network, and they are internal transactions to the Federal Reserve between Federal Reserve banks, and also include transactions between commercial banks.

The CHAIRMAN. All right.

Mr. Widnall, would you like to interrogate the witness?

Mr. WIDNALL. Thank you, Mr. Chairman.

Mr. Mitchell, we appreciate your coming here before us today; and your testimony is certainly going to be very valuable in consideration of the bill.

I regret very much that the chairman, Dr. Burns, cannot be here, not that you are not an adequate witness.

Mr. MITCHELL. I regret it, too.

Mr. WIDNALL. I am deeply disturbed by the way the record is colored by statements that have been made through the chairman on things that to me are completely irrelevant in the consideration of this bill, and that seek to draw attention to minor, minuscule things that to me have absolutely no business in connection with this investigation.

For instance, on page 8 of the statement that we have before us, an allegation is made that \$25 was paid as reimbursement by a staff member for an honorarium to a guest clergyman who delivered the invocation at the annual meeting of the New Jersey Bankers Association.

I think it is just absolutely inappropriate, not pertinent to the issues before us that are extremely important, and the sort of thing that will be picked out by the press and played up in the headlines without any mention of the major issues that are before the committee.

And I think it is extremely unfortunate that we get into those things. I cannot conceive of any organization or groups meeting anywhere at any time without having some kind of expenses that would normally go with the operations of particular—

The CHAIRMAN. Will the gentleman yield?

Mr. WIDNALL [continuing]. Yes, I will yield.

The CHAIRMAN. That information was furnished by the Federal Reserve as unusual expenses. They gave us a listing of the unusual expenses, and what they were for, and that was one of them. We would have never known it otherwise.

Mr. WIDNALL. I do not have any particular questions to ask you in connection with this. I think you have covered the subject matter very well, and I certainly think you have justification for the construction of additional Federal Reserve facilities. The volume of your operation has expanded tremendously. And in keeping with changes in the economy and changes in the operations and the handling of operations

you have to update your facilities and modernize the equipment that you have. And naturally, that involves some major expense.

I certainly am mindful of the expenses right here on Capitol Hill and what we do to take care of ourselves, with the lunches that we have, with the cigarettes and cigars and other things. And it sometimes hurts me to sit in judgment of others when we are some of the worst transgressors up here right on Capitol Hill.

Thank you very much.

The CHAIRMAN. Mr. Barrett.

Mr. BARRETT. Governor, I think you have made a very splendid statement here. I doubt that anyone could pick out any reason to complain about it. However, I noticed on page 13 you indicate that in February, Chairman Burns had written to the chairman of our committee indicating that he thought the expenses might total about \$71.45 million, and he considered that as a reasonable estimate through 1977.

And, of course, down at the bottom on page 13, you indicate now that as of February the cost would be increased to about \$76.2 million.

I was wondering how much of the \$60 million recently originally authorized for construction of bank facilities would remain in the fund?

Mr. MITCHELL. Mr. Barrett, I think that that fund is down to a million dollars or less. It is down to a very low level, and in fact we are in a position now where we cannot do anything until we get further authorization. With regard to the buildings that we are talking about, such as I recall, the building in Los Angeles where we badly need additional space, is projected to cost about \$25 million; I think the one in Baltimore will cost about the same; and those in Charlotte and Omaha, about half that much.

But we do not have any significant funds remaining in the authorization at the present time. It is a nominal amount. I think it is just about \$1 million or less.

Mr. BARRETT. Well, in our legislation we always hear the echoing sounds from the administration that you cannot spend that kind of money for higher minimum wage; you cannot spend that kind of money for housing for the low- and moderate-income families because of the impact that such moneys would have on the economy.

Would you not think this kind of money being spent for bank structures would also have a detrimental impact on the economy?

Mr. MITCHELL. Well, the economy as it grows needs more money, and it needs more checks. And they have to be supplied by someone, and that is the Federal Reserve's function.

Mr. BARRETT. But the question I am asking you, would not this kind of money expended for building construction have the same detrimental effect on the economy equally the same as it would if it were spent for building homes for the lower and moderate income?

Mr. MITCHELL. I think I am getting your drift now, sir. When we had a problem like that in Minneapolis, several years ago, we just held up construction on that building temporarily. Construction of these buildings will not take place in this period of tight money because the plans are not ready. Construction is sometime in the future.

Mr. BARRETT. Well, do we have now in the record that you will not spend this kind of money until after the economy has been brought to a reasonable level?

Mr. MITCHELL. Yes, sir.

Mr. BARRETT. That is in the record?

Mr. MITCHELL. That is in the record.

Mr. BARRETT. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman.

Governor Mitchell, yesterday Mr. Staats of the GAO testified with respect to the total transactions in 1970 of the Federal Reserve System, and his testimony was, and I am quoting from the transcript, "In 1970 the total transactions reported were \$738 billion."

Now, the Chairman asked you about this earlier, and I thought you said that that was not the correct figure.

Mr. MITCHELL. I do not know where that figure could have come from. Let me give you the transactions numbers that I have.

Mr. BROWN. Well, Governor Mitchell, you have questions about this statement, then?

Mr. MITCHELL. I think it is——

Mr. BROWN. You can correct it for the record.

Mr. MITCHELL. I do not know where the numbers could have come from.

Mr. BROWN. Then later on in his testimony in answer to questions, I asked Mr. Staats about an exhibit that he had put in the record, which was a one paragraph statement of your independent auditor, and I asked him if that was the complete audit report.

In his response Mr. Staats said, "That is all that has been made available to the Congress."

Now, that quite truly is wrong, is it not?

Mr. MITCHELL. Let Mr. Solomon comment on that.

Mr. SOLOMON. Mr. Brown, that is not correct. A more complete report, of which I have a copy here and I would be glad to insert it in the record, was made available to this committee and to the committee of the Senate.

Mr. BROWN. And it has been since about 1952, has it not?

Mr. SOLOMON. That is correct.

Mr. MITCHELL. Not only that, but my understanding, Mr. Brown, is that the working papers of the auditing firm are available for review and examination.

Mr. BROWN. Well, at least then, Mr. Staats appears to be rather incorrect in his understanding on both of these points, is he not?

Mr. MITCHELL. Correct.

Mr. BROWN. Governor Mitchell, I do not know if you had an opportunity to review Mr. Staats' testimony of yesterday.

Mr. MITCHELL. I read his statement, yes, sir.

Mr. BROWN. But let me ask you, under option No. 1, the type of audit he explained, would you have objection to that type of audit?

Mr. MITCHELL. Well, the Board's position on that, Mr. Brown, is that we are doing that job; and we feel we are doing it in an excellent way and in a satisfactory way; and in our judgment it would be an opening wedge that will lead to review of policymaking.

Mr. BROWN. In other words, you are saying that if you open the door with option No. 1, soon you have option No. 2, and eventually you have option No. 3.

Mr. MITCHELL. That is exactly it.

Mr. BROWN. Yesterday in my questioning of Mr. Staats he agreed that the objective of this bill as far as its audit provisions are concerned, H.R. 10265, he agreed that the objective could be accomplished if the GAO auditing requirements, guidelines, informational and data minimums to be included in your audit report.

Does that sound to you as a better alternative than an actual audit by GAO?

Mr. MITCHELL. Yes; it does. Yes.

Mr. BROWN. That would eliminate your concern about their getting into an actual policy audit, plus it would eliminate the duplication if the GAO ends up auditing the auditors who have audited the earlier auditors. Right?

Mr. MITCHELL. Yes.

Mr. BROWN. I have no further questions, Mr. Chairman.

The CHAIRMAN. Mr. Reuss.

Mr. REUSS. Thank you, Mr. Chairman.

Welcome, gentlemen.

Governor Mitchell, you pointed out that between last February when Chairman Burns wrote Chairman Patman about the building fund and today, the cost of those four branches, has increased from \$71.45 million to \$76.2 million.

Would it be satisfactory to you if this committee, assuming it views favorably your general request, would put in an additional limitation of, say, \$80 million; because if costs have increased that much in the last 7 months, it would seem to me that if we just put in the current cost, we are going to find that you can only build half a building in Omaha.

Mr. MITCHELL. I think that is more realistic than this number, yes. Because of the way in which building costs are rising—in fact, the plans have not been completed for any of these buildings—and so there will be a period of time before construction begins.

Mr. REUSS. I will ask the staff now to prepare such an amendment for me, which I shall offer.

On another subject, Governor Mitchell, on page 9 you referred to, and I quote, "critical informational constraints that should be imposed" in any GAO audit. You say they include:

Exemption of examination reports of member banks, certain transactions conducted with and on behalf of foreign central banks, and sensitive information about open market and discount operations. Much of the information in the latter two categories becomes available with a lag.

And you point out that "A high degree of confidentiality in these areas is essential."

I find what you say persuasive on that. Would you accordingly—since we are in executive session tomorrow it would be well to have it today—prepare for us some suggested language which, if in the wisdom of this committee we should authorize a general GAO audit, would exempt the indicated confidentiality areas?

This committee has always tried in its relations with the Treasury, for example, to cut out of what we ask those areas where there really is a need for confidentiality. And I would be appreciative if you could do that.

Mr. MITCHELL. We can do that.

Mr. REUSS. Thank you.

Let me raise another question. The Open Market Committee is authorized to buy securities in the open market and hold them for its own account. That is how you got the \$75 billion you are talking about.

Dr. Burns recently testified with justifiable pride that the Open Market Committee has been buying Fannie May bonds this summer in order to help the housing market. I for one applaud such efforts.

There is another kind of Federal securities which I would like to see the Open Market Committee buying, and those are that type of Federal securities known as flower bonds. These are the long-term bonds which can be redeemed at par value regardless of their market value in order to pay the estate taxes. And this is how they work: A rich man feeling the tap on his shoulder directs his attorney to buy these flower bonds, and the attorney buys, let's say, \$1 million worth of them. Take the 1998 issue, currently selling at \$740,000. Then when the rich man dies the Treasury accepts the bonds at par value, so he gets by with paying \$1 million debt for \$740,000 and saves \$260,000, which of course means that the other 80 million taxpayers have to make it up in the taxes they pay.

To its credit, Congress in 1971 plugged this loophole as to the future and prevented future flower bonds, but there are still \$32 billion of old ones in existence, of which \$22 billion are long-term, which are selling at a discount and are profitable for estate tax purposes.

The Treasury estimate that the average annual loss in revenues to the taxpayers through this loophole is $\$ \frac{1}{4}$ billion, which means that the average taxpayer has to make up the difference. The Open Market Committee could strike a blow for the average taxpayer if it were willing to purchase some of these bonds as they come on the market. Moving prudently, of course, in that direction, the Open Market Committee could even make some money on it, because, with the current bond yields, these bonds are selling at a market discount, and of course the Fed would hold them to maturity, and thus realize not only a reasonable interest rate in the interim, but a capital gain on maturity. The Fed, of course, is not a profitmaking body and this should not be a primary concern anyway. And the Treasury and the taxpayers would, as I say, save up to \$250 million by doing this.

Is there any reason why the Federal Reserve cannot help out the hard-pressed taxpayer by buying up some of the flower bonds? If you haven't thought of the matter and are unable to answer fully now, I would be glad to let you and your associates answer for the record.

Mr. MITCHELL. Well, I think it is something we might look into. I suspect that there is enough of a premium on those bonds so that the funds that we turn over to the Treasury at the end of the year's operations might reflect the fact that we had invested in a security that was not as good from a yield standpoint as another security.

Mr. REUSS. The Treasury does estimate, as I say, that the overall loss to the taxpayers—

Mr. MITCHELL. Well, as I say, it does need some looking into.

Mr. REUSS continuing]. Is \$250 million. But I'm delighted with what you say, because you and your associates are not opposed to giving a boost to the average taxpayer if you can conduct your open market policy in a way that will help him.

Mr. MITCHELL. Certainly not. But the method that the manager uses in deciding what to buy is to first ask the dealers at what price will they sell securities? He gives them a long list of securities that he might

be interested in. The dealers make him an offer, and then he takes the best yield.

Mr. REUSS. The social security fund, you know, owns quite a lot of these flower bonds, and they should be congratulated because that means they take them off the market and prevent somebody from using them as a loophole.

Mr. MITCHELL. Has the Treasury bought them?

Mr. REUSS. I don't think the Treasury owns any, but the social security fund does, and I would appreciate your views on this.

Mr. MITCHELL. We will look at this.

Mr. REUSS. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Williams.

Mr. WILLIAMS. I want to thank Mr. Mitchell and Mr. Solomon for being here this morning.

From the testimony yesterday, which we received from Mr. Staats, I understand that the GAO conducts an internal audit of its own operation, and at the same time brings in outside auditors to do an audit, and that the Federal Reserve Board is doing exactly the same thing. Is this correct?

Mr. MITCHELL. I don't know about the GAO, but that is our practice; yes, sir.

Mr. WILLIAMS. Well, Mr. Staats made the point yesterday that that is what is happening. Do you see any reason for Mr. Staats to want to get into an audit of the Federal Reserve Board any more than the Federal Reserve Board might want to get into an audit of the GAO?

Mr. MITCHELL. Well, we do not want to get into the auditing business, except internally, and I do not know that I can offer any comment on that.

Mr. WILLIAMS. Yesterday, Mr. Staats made the statement that there is a turnover in the Federal Reserve Board of \$738 billion annually. How much of this \$738 billion turnover is due to borrowing money to pay off maturing Federal obligations and printing money in exchange for Government bonds in order to cover Federal deficit spending?

Mr. MITCHELL. Well, I am having a little trouble with the \$738 billion figure.

Mr. WILLIAMS. \$738 was his exact figure. I think the record will show that.

Mr. MITCHELL. I have some trouble with that, so just let me tell you the numbers that I can identify. Last year we purchased \$24.5 billion worth of securities, Treasury securities, and we sold \$17.5 billion in Treasury securities. We made repurchase agreements amounting \$33.9 billion. Now, out of that we netted an increase in our portfolio of \$5 billion.

Mr. WILLIAMS. What?

Mr. MITCHELL. \$5 billion.

The CHAIRMAN. You mean \$5 billion, don't you?

Mr. MITCHELL. \$5 billion, that was the addition to our portfolio last year. In other words, it went from \$70 to \$75 billion last year.

Mr. WILLIAMS. So, in other words you have difficulty justifying the \$738 billion.

Mr. MITCHELL. Let me give you another figure here. We exchanged securities with the Treasury of \$64 billion. That might be another

number that was added into his total. But then, after that, the numbers that I can find do not start to amount to anything like \$738 billion, so I think it is a case where we probably should get in touch with the Comptroller General, and see what he has got in his totals. I do not know.

Mr. WILLIAMS. What you are really saying, I believe, is if we the Congress could balance the budget and start to pay off some of the money we owe, rather than borrowing money to pay off the money we owe, and borrowing it at two and three times the interest rates that the maturing obligations carry, then the turnover of the Federal Reserve Board and the task of the Federal Reserve Board, would be greatly reduced?

Mr. MITCHELL. Well, I'm not really saying that. Our activities are based upon the forces that influence financial markets, and the absence or the overabundance of bank reserves. We supply reserves with our purchases, and we absorb them with our sales. And so in order to even out the market, we have a large number of transactions.

Mr. WILLIAMS. What happens in the years when the Federal Government has a deficit of \$30 billion?

Mr. MITCHELL. Well, under present operating conditions, the market takes most of that deficit. It buys those securities.

Mr. WILLIAMS. And that is why we are up to 9 percent for Treasury bills?

Mr. MITCHELL. Yes, and 7½ percent for bonds.

Mr. WILLIAMS. And 8.6 or 7 for a Treasury note.

Mr. MITCHELL. Our contribution to the Treasury financing is on the order of the \$5 billion that I mentioned, and that is determined by what we think the economy's needs for moneys are.

Mr. WILLIAMS. Now, also in Mr. Staats' testimony yesterday, he stated that the bill we have before us, H.R. 10265, provides that "GAO shall have access to reports of examinations of member banks. We have assumed that this language would give us access to any number of reports, including the reports of the FDIC."

We go through this about every 2 or 3 years, and the Chairman of the FDIC, 3 years ago I believe, made the statement that he would not turn his records over to the GAO because the Federal Deposit Insurance Corporation does a regular audit of all banks. They find some banks to be borderline cases, very close to failing, and they force these banks to take remedial steps, so they can stay open. If this were to leak out, and I know that we have had some leaks from the GAO, then this would cause a run on the bank and cause it to close.

Do you really think that the FDIC records should be turned over to the GAO?

Mr. MITCHELL. No, our position is examination reports ought to remain confidential in the examining agency.

Mr. WILLIAMS. I want to conclude by stating that of the three alternatives that were offered to us yesterday, the first one is doing little more than reviewing what you have done. The second alternative not only includes everything done by the first alternative, but also permits the GAO to examine the management of resources to evaluate the efficiencies and economy with which resources are used. Such audit work would determine the causes of deficient or uneconomical practices found, and propose constructive recommendations for improvement

for the consideration of management officials. It also states that the GAO would make recommendations for obtaining a more economical and efficient administration of the entities audited.

Now, that is just the difference between one and two. If you wanted to take three also, you will actually become a policymaking group. I want to agree with Mr. Brown that if we get started on this road, it could lead to a very dangerous precedent, where the GAO would be setting the policies of the Federal Reserve.

The CHAIRMAN. The time of the gentleman has expired.

Mr. Ashley?

Mr. ASHLEY. Thank you, Mr. Chairman.

Governor Mitchell, needless to say, I welcome you as do the others, and with enormous respect and admiration. I think you have made a very persuasive statement, and I commend you for it. I do not think there is any question but that any audit that this committee may be considering may be duplicatory. I do not think that is really the issue involved, to tell you the truth. I think that the Congress feels that it does have its own independent responsibility, to which we must be responsive, and frankly, I tend to be sympathetic to that.

The cost in terms of additional dollars does not appear to be very much, on the basis of what General Staats testified yesterday, something in the neighborhood of \$100,000. I did indicate concern yesterday with the kind of third alternative audit that he described for us, because I very much agree with you that this encompasses some judgmental areas that, in my view at least, could produce very counterproductive results over the long term, and perhaps the short term.

I was interested, as was Congressman Reuss, in your handling of the subject matter on page 9 of your statement, where you describe some of the particularly sensitive areas where informational constraints in your view should be imposed, and I would simply ask you whether you are familiar with the same kinds of exemption that you insist upon which were adopted when the Congress deemed it necessary or appropriate to provide for a GAO audit of the exchange stabilization fund? It is my understanding, and I have looked at the language in the GAO audit authorization that was adopted, I believe, in the late 1960's, that there was exemption for the types of transactions that you describe as having peculiar sensitivity. Are you familiar with that?

Mr. MITCHELL. I am not familiar with that language, Mr. Ashley. I know just a little bit about the auditing of the exchange stabilization fund, but I do not know anything about that language. But I think, in light of another question that was asked, we should take a look at it when we submit a statement. I guess Congressman Reuss asked for a statement as to how we might word this exemption. We would then be looking at that language.

Mr. ASHLEY. Well, I am sure that your legal people would look at that language with the view that Congress did give consideration to the necessity for exempting peculiarly sensitive areas of subject matter, so that there is precedent in this regard.

That is all I have, Mr. Chairman.

The CHAIRMAN. Thank you. Mr. Roncallo?

Mr. RONCALLO. Thank you, Mr. Chairman, and thank you, gentlemen, for your testimony today, and I have no questions. I yield back the balance of my time.

The CHAIRMAN. Mr. Moorhead?

Mr. MOORHEAD. Thank you, Mr. Chairman.

Welcome, Governor Mitchell. I gather you are familiar with the three alternatives that General Staats proposed to us?

Mr. MITCHELL. Yes, I am.

Mr. MOORHEAD. Does your outside auditor carry out the functions of the first alternative proposed by General Staats?

Mr. MITCHELL. Yes.

Mr. MOORHEAD. How about the second alternative?

Mr. MITCHELL. Well, our outside auditor, to the best of my knowledge, has not done much on that, a very little bit. But we have employed some outside consultants to look at particular situations, say computer utilization, which was an efficiency review. We had our computer installation examined by an outside firm this past year to see if it conformed to the latest design and utilization practices. Our outside auditor, I think, primarily is concerned with a financial audit.

Mr. MOORHEAD. So if we direct the GAO to do alternative 1 and alternative 2, it is possible that the Board would be satisfied with the work. It could eliminate your private outside auditor and maybe your computer consultants. Is that correct, sir?

Mr. MITCHELL. It depends upon the quality of the work. Now, I indicated earlier that the Federal Reserve has some unique operations, both as to scale and to character, and our experience with outsiders who come in to review and evaluate that has been quite disappointing. We use them on a highly selective basis.

Mr. MOORHEAD. You mean your CPA's?

Mr. MITCHELL. Yes, that's right. Even the management consulting firms who have looked at some of these things, I think, have not given us a very big yield on the amount of money we pay them for looking into Federal Reserve operations with which they have had no previous experience, either as to scale or character. And so I think that I would not expect a large yield from that.

There were two things about the Comptroller's statement that puzzled me a little bit, and maybe I ought to bring that up at this point if it is agreeable to you. He specifically pointed to the Federal Advisory Council and to the Federal Open Market Committee. The Federal Open Market Committee, for example, does not have any staff, it does not have any expenditures, it does not have any receipts, it does not have any assets, it does not have any liabilities. What is going to be audited?

Mr. MOORHEAD. Well, I think you would agree with me, Governor Mitchell, that when you get down to the Open Market Committee, you are down to the third alternative.

Mr. MITCHELL. Yes, you are in the third alternative.

Mr. MOORHEAD. I believe that so far as the first two are concerned, the decision is a relatively simple one. Do we have some duplication or not? Is this going to interfere in any way, with your policymaking? I think that you could live with options 1 and 2. I think your major objection is you think that if we adopt 1 and 2 down the road, we get to 3. So this is the kind of—

Mr. MITCHELL. That is the kind of problem, I think, that we face.

Mr. MOORHEAD. But it is No. 3 where we really get down to a very difficult decision. I believe you agree with me when, on page 10 of

your statement, you say there would be pressures which would cause the Federal Reserve to dilute or compromise its best monetary or credit judgment to shortrun rather than longrun interests. I would certainly concede that if the Congress set up some kind of day-by-day mechanism to look over daily decisions of the Open Market Committee, clearly the independence and the whole idea of insulating the Federal Reserve monetary decisions from particularly political pressures would be completely compromised.

Mr. MITCHELL. Yes, I think so.

Mr. MOORHEAD. But I wonder could we not renew the public's confidence in the Federal Reserve and all institutions of Government if we had a type 3 audit by the General Accounting Office?

Mr. MITCHELL. Well, we are supplying a record of the policy actions of the Federal Reserve to Congress every 3 months now, as you know, and that essentially summarizes what happens, what the environment was as the committee saw it, and what happened as a result of that. The only thing that is not supplied is the detailed record, what people said on one side or the other. But I think that the policy record, which becomes available 90 days after each meeting, permits anyone to evaluate the committee's actions right then and there, that is in the public record. If you were going to conduct an audit, you could audit that kind of thing and you could do it right now.

Mr. MOORHEAD. Maybe that is coming down to it. What you do not want, then, is to supply to anybody the fact that Jones voted to buy and Smith voted to sell. Is that it, or am I oversimplifying it?

Mr. MITCHELL. You inhibit people's expression and their freedom of action if they make a decision that in retrospect does not look very good. The decision has to be made every day the committee meets. It must make a decision, and that decision has to last until the next meeting of the committee. There is no way of ducking it. And so you are exposed, because you can not always bat 1,000 in this game. You are going to miss part of the time. And I think that the point about disclosing the full gamut of discussion currently is that it would inhibit the quality of expression and the kind of give and take that takes place in formulating those judgments. It is, in effect, an executive decision, and has all the characteristics of an executive session.

Mr. MOORHEAD. Our committee has had open executive meetings, so I know what you are talking about.

Thank you very much. Mr. Chairman, my time has expired.

Mr. CHAIRMAN. We have the mass transit bill on the floor immediately after 12. We will have to be there, and of course this committee sponsors the bill.

I will ask Mrs. Boggs to preside, so that I can go ahead and get ready for the bill to come up, and she can conclude the hearing this morning. We will recess when we get through here with this witness, until tomorrow morning at 10. We will start with the markup of the bill tomorrow morning at 10. All right, Mrs. Boggs, if you will preside.

Mrs. BOGGS [presiding]. Mr. Johnson?

Mr. JOHNSON. I have no questions.

Mrs. BOGGS. Thank you so much, Governor Mitchell and Mr. Solomon, for being here today. And the only question that I would have to ask you, because you have answered all the questions that

I took notes on as you went along in your responding to the members, is this: I notice that you are not going to spend the money on construction until the credit crunch is eased?

Mr. MITCHELL. Yes, ma'am.

Mrs. BOGGS. Could you please, perhaps, forecast to us when you expect to start spending that money?

Mr. MITCHELL. Well, we forecast internally but not externally.

Mrs. BOGGS. Thank you very much for your excellent testimony.

The hearing is adjourned.

[Whereupon, at 11:30 a.m., the hearing adjourned to reconvene at 10 a.m., Thursday, October 4, 1973, in executive session.]



